

Minnesota Department of Finance

November 1996

Highlights

Budget Outlook up \$468 Million in F.Y. 1998; \$448 Million in F.Y. 1999

General fund revenues for F.Y. 1998 are now forecast to exceed expenditures by \$468 million. In F.Y. 1999, the difference between revenues and spending is forecast to be \$448 million. New, ongoing commitments in the 1998-99 budget will need to be limited to those annual amounts to avoid creating an imbalance in the 2000-01 biennium.

Robust Economy, One Time Revenue Gains Provide \$522 Million Balance for Current Budget Period

The U.S. economy rebounded from last winter's mini-slump more quickly than expected. The resulting increase in activity has added revenue to the outlook for the 1996-97 biennium. Revenues for the current biennium are forecast to total \$19.099 billion, up \$646 million (3.5 percent), from end of session estimates. Expenditures are now expected to be \$18.644 billion, down \$209 million (1.1 percent). These gains are partially offset by other changes totalling \$63 million, leaving a forecast balance at the close of the biennium of \$793 million.

Not all of that balance will be available for new initiatives. Current law dedicates the first \$114 million of the forecast balance to a new school aid reserve. An additional \$157 million must be used for a one time change in the payment schedule for school districts. These statutory obligations reduce the available balance to \$522 million. This balance cannot be used to fund ongoing expenditures without creating potential budget problems for future years.

Budget Reserve Is \$261 Million

Minnesota's budget reserve is now \$261 million, 1.4 percent of biennial spending in 1996-97. Minnesota's Council of Economic Advisors cautioned that this is well below the target of 5 percent established following the financial problems of the early 1980s.

November 1996 Economic Forecast

BUDGET SUMMARY

1996-97 Budget Outlook

Strong Economy, One Time Events, Create \$522 Million Surplus

General fund revenues for the 1996-97 biennium are now forecast to total \$19.099 billion, \$646 million (3.5 percent) more than expected at the close of the legislative session. General fund expenditures are projected at \$18.644 billion, \$209 million less than end-of-session estimates. These gains are partially offset by other changes totalling \$63 million. This yields a \$793 million forecast balance for the current biennium prior to adjustments required by law.

Current law commits the first \$114 million of any projected surplus to create a new school aid reserve account. An additional \$157 million is dedicated to fund a one time change in the schedule of payments to school districts. After these statutory obligations are met, an available balance of \$522 million remains for the 1996-97 biennium.

F.Y. 1996-97 Forecast

(\$ in Millions)

	<u>End of Session</u>	<u>November Forecast</u>
Revenues	\$18,453	\$19,099
Expenditures	<u>18,853</u>	<u>18,644</u>
Difference	(400)	455
F.Y. 95 Balance Less Reserves and Carry Forward	401	338
Forecast Balance	\$1	\$793
Less: School Aid Reserve	---	(114)
Less: School Payment 90/10	---	(157)
Available Balance	\$1	\$522
Cash Flow Account	350	350
Budget Reserve	270	261

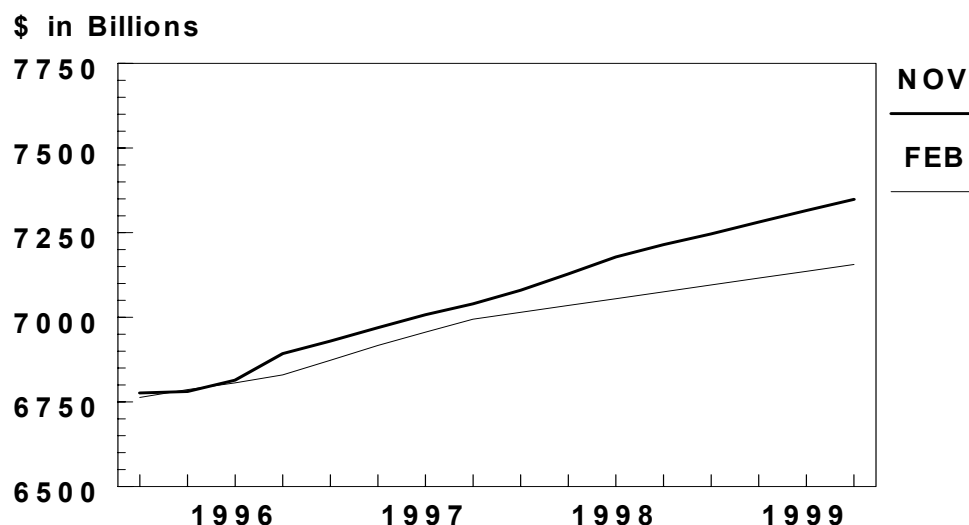
The budget reserve is now at \$261 million. Current law reduces it from the \$270 million set in the 1996 legislative session by appropriating \$9 million to replace cuts in federal low income home energy assistance. Minnesota's budget reserve is now only 1.4% of biennial expenditures, well below the 5 percent target established following the state's financial problems of the early 1980's.

Economic Growth Stronger Than Expected in 1996

When February's forecast was prepared, there was widespread concern about the future path of the U.S. economy. Few forecasts included a recession in 1996 or 1997, but all contained substantial notes of caution. February's Control forecast from Data Resources Inc. (DRI) was typical, calling for real GDP to grow in 1996 at only a 1.7 percent rate.

Since February, the outlook has changed dramatically. The economy now appears positioned to enter an extended period of growth. Real GDP growth in 1996 is now expected to be at a 2.4 percent rate, and the consensus is that the economy will continue to grow at roughly the same rate through mid-1999, the end of the next biennium. The current expansion has lasted for more than 67 months, 12 months longer than average. The Control forecast of no recession through 1999 would yield the longest peacetime expansion in the postwar period.

ECONOMY STRONGER IN 1996 -- GROWTH CONTINUES IN 1997, 1998 AND 1999



Economy, One Time Events Add to State Revenues

General fund revenues in 1996 and 1997 benefit from favorable one-time events, as well as the improved economic outlook. Forecast revenues for the four major taxes were raised by nearly \$598 million, about 3.7 percent. The forecast for individual income taxes increased \$427 million; the sales tax \$81 million.

**Revenue Outlook Improves
Change in Forecast
(\$ in Millions)**

	<u>F.Y. 1996</u>	<u>F.Y. 1997</u>	<u>Biennium</u>
Revenues			
Income	\$150	\$277	\$427
Sales	29	52	81
Corporate	21	30	51
Motor Vehicle	<u>22</u>	<u>17</u>	<u>39</u>
Major Taxes	222	376	598
All Other	<u>(58)</u>	<u>106</u>	<u>48</u>
Total Revenues	\$164	\$482	\$646

Much of the additional income tax revenue came from one-time events. Rapid increases in stock prices during 1995 appear to have produced extraordinary growth in taxable capital gains, which led to higher than anticipated tax year 1995 settle-up payments. Passage of the Federal Agriculture Improvement and Reform Act of 1996 changed the expected flow of farm program payments, increasing gross farm income in Minnesota. Higher commodity prices and generally good crop yields also increased farm income in 1996. Merger and acquisition activity involving locally based companies will also add one time gains to state revenues.

Expenditures for F.Y. 1996-97 Biennium Are \$209 Million Lower

Changes to the human services' forecast accounted for nearly all the \$209 million decrease forecast in state spending. Health and human services expenditures for F.Y. 1996-97 are \$199 million lower than end-of-session estimates. Nearly half of those savings are due to one-time events. County obligations from F.Y. 1995 were paid in F.Y. 1996, saving \$67 million. Basic health care costs are lower than anticipated due to a delay in implementing managed care programs. This defers expenditures of \$26 million into the next biennium.

Other changes in the \$4.6 billion health and human services expenditure forecast are relatively modest. Lower health and income maintenance costs reflect the lower enrollment growth expected to accompany a strong economy. Service costs for existing populations have also been lower than anticipated, leading to savings in the General Assistance Medical Care and Medical Assistance programs.

1998-99 Budget Outlook

\$468 Million Balance Available in F.Y. 1998; \$448 Million in F.Y. 1999

General fund revenues for the 1998 fiscal year are now forecast to total \$10.016 billion, while expenditures are projected at \$9.548 billion. For fiscal 1999, revenues are projected to be \$10.468 billion with \$10.020 billion in spending. The difference between revenues and spending is \$468 million in F.Y. 1998 and \$448 million in F.Y. 1999.

F.Y. 1998-99 Budget (\$ in Millions)

	<u>1998</u>	<u>1999</u>
Forecast Revenues	\$10,016	\$10,468
Projected Expenditures	<u>9,548</u>	<u>10,020</u>
<i>Difference</i>	<i>\$468</i>	<i>\$448</i>

Projected 1998-99 expenditures are based on an extension of current law and policies, and include changes in caseload, enrollments and discretionary inflation of 3 percent per year. The estimates continue to reflect the education spending limits enacted for F.Y. 1998-99.

Slower Growth Without A Recession Would Reduce Revenue

Most economists believe it is unlikely that there will be a recession before the close of the 1998-99 biennium. But, that does not mean there is no downside risk to the revenue forecast. The current DRI Control forecast assumes that the economy will grow at its full potential during the next 3 years. There is, of course, no guarantee that rate of growth can be sustained. Should the economy grow at the 2.0 percent rate observed in 1995, state revenues for the 1998-99 biennium would be materially lower than in this forecast. The possibility that state revenues could be less than projected, even in times of relatively strong economic growth, must be considered in budget plans for the next biennium.

Revenues Expected to Grow at 3.9% Annual Rate in 2000-2001

This report also contains the first planning estimates for revenues and spending for the F.Y. 2000-01 biennium. These planning estimates provide a necessary framework against which the long-term impact of potential 1998-99 budget decisions can be judged. The planning estimates do not include any spending or tax changes beyond those in current law. Expenditures have been increased to reflect discretionary inflation and caseload or enrollment growth.

Four Year Planning Horizon
(\$ in Millions)

	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Forecast Revenues	\$10,016	\$10,468	\$10,847	\$11,304
Projected Expenditures	<u>9,548</u>	<u>10,020</u>	<u>10,496</u>	<u>10,949</u>
<i>Difference</i>	<i>\$468</i>	<i>\$448</i>	<i>\$351</i>	<i>\$355</i>

Projected revenues and expenditures for 2000-01 are nearly equal. Care must be taken in developing the 1998-99 budget to ensure spending does not exceed revenue in the following biennium. It is important for policymakers to recognize differences between the fiscal impacts of one time and continuing spending. Both the amount and timing of new or increased spending can materially affect the balance of revenues and expenditures in coming biennia.

ECONOMIC SUMMARY

Nine months ago when the most recent revenue forecast was prepared, there was greater uncertainty than usual about the economy's future course. Economic growth had slowed dramatically in late 1995. Consumer confidence was down, holiday spending had been weak, and inventories were well above normal levels. The economic dislocation caused by the federal government shutdowns and the Boeing strike was in the past, but no one was certain when consumers would begin to spend again. Auto inventories appeared uncomfortably high, and there was a real possibility that the mini-inventory cycle already underway would turn into a full scale slowdown.

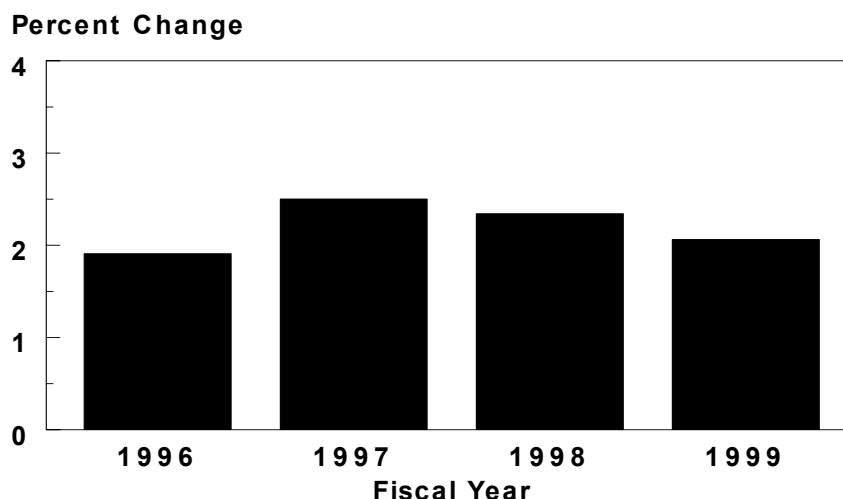
A lack of information on the current state of the economy further muddled the outlook. National economic statistics were one of the first casualties of the government shutdown and much of the economic data normally used to update forecasts had been missing since early December. Even more distressing, those few bits of economic data that were available indicated that a more severe retrenchment than had been thought likely only one or two months earlier was underway. January's payroll employment report, which showed a drop of slightly more than 200,000 jobs, was interpreted by many as a sign that a slow growth economy during the first half of 1996 was the best that could be expected.

The Control forecast of Data Resources Inc., (DRI), Minnesota's national economic consultant, reflected that increased uncertainty. Between November and February the Control scenario went from optimistic to cautious, and the principal alternative to Control changed from a more optimistic scenario to one containing an immediate recession. In February DRI believed that consumers would take until mid-summer to shed their worries and begin spending at a rate consistent with more than token growth. By fall, a pattern of strong sustainable growth was expected to emerge, providing the momentum necessary to sustain the economy well into the 1998-99 biennium.

It now is obvious that nearly all forecasters, including DRI, underestimated the economy's strength during the first half of 1996. The late 1995 slump in consumer spending was actually worse than suspected at the time, but that economic stall was extremely short lived. Consumers resumed spending almost immediately in early 1996, quickly working down inventories and eliminating the threat of an extended inventory correction.

Other good news followed. February payroll employment increases more than made up for January's job losses, housing activity during the first half of 1996 was much stronger than expected, and sales of cars and light trucks vehicle sales exceeded first quarter estimates, drawing down auto inventories to more normal levels.

Steady Growth Expected in Next 3 Fiscal Years (Real GDP Growth, \$87)



By late spring slow growth was no longer a concern. Growth rates appeared to be so strong that fears of inflation were rekindled. The economy cooled on schedule during the third quarter, however, with no notable increase in inflation. Now we are in what most would agree is the best of all situations. The U.S. economy is presently expected to grow at roughly its long run potential rate with near full employment and no apparent inflationary pressures. The usual imbalances on which analysts focus as they search for the next turn in the economy have largely disappeared.

Forecasters are quick to point out that our current situation cannot be maintained indefinitely, and that today's good times do not mean that recessions have been relegated to something only to be read about in history books. But, usually there are significant lags between the emergence of the production bottlenecks and imbalances which accompany an economy which is overheating and the arrival of the higher inflation and higher interest rates which eventually produce an economic slowdown. With no major imbalances identifiable at present, the prospects for a prolonged period of economic growth extending beyond the next biennium are extremely good. DRI chief economist David Wyss remarked recently that he believed it was possible for the economy to avoid a recession until at least the turn of the century.

DRI's November Control forecast is consistent with this relatively sunny consensus economic outlook. Expected real GDP growth rates for fiscal 1997, 1998, and 1999 all are consistent with those possible under a period of sustained growth and low inflation. Differences between the Control forecast and the Blue Chip Consensus outlook are small.

Members of Minnesota's Council of Economic Advisors were in general agreement with the DRI outlook. Individual members were slightly more or slightly less optimistic as is often the case, but the differences between their own personal forecasts and the Control forecast were smaller than usual. The Council and Finance Department economists agree that it is equally likely that the economy will out perform or under perform the Control forecast over the next 32 months. The gains from any growth beyond that in the Control forecast, however, were thought to be smaller than the potential losses should the economy not perform as well as forecast.

Council members cautioned against believing that the economy will actually follow the relatively smooth path forecast by DRI. Unforeseen international events, the weather, and other unanticipated exogenous shocks will cause minor accelerations and decelerations in the growth rate over the next few years. At this point, however, Council members and Finance Department economists believe that the U.S. economy has sufficient underlying strength to withstand the normal series of shocks which continually reshape the economic outlook.

This extended period of economic growth creates a pattern of revenue growth for the state which is probably not sustainable over longer time periods. The Council urged the Governor and the Legislature to exercise great caution in their spending decisions, avoiding making longer term commitments to projects and new programs which cannot be sustained financially from future revenues.

Council members and Finance Department economists also were concerned that policy makers not assume that there is no downside risk to the current, relatively upbeat outlook. Much of the current optimism is based on the diminished possibility of recession, but there is no guarantee that the economy will not grow more slowly than DRI projects. Council members noted that some business economists make it a standard practice to include one year of recession in their mid-term forecasts to make sure company officials remember that the possibility of an economic downturn or simply slower than anticipated growth is incorporated in their firm's planning. Finance Department economists noted that while the method used to create the planning estimates for revenues in 2000 and 2001 yields more conservative results than the Control forecast, that will not protect state revenues against a significant slowdown in the economy, let alone a recession.

DRI assigns a 55 percent probability to the November Control Scenario. A boom-bust scenario, in which a recession begins in 1999 is given a 35 percent probability. The second alternative scenario, probability 10 percent, includes a recession in 1997.

Council members noted that the boom-bust scenario had relatively little boom. Finance Department economists agreed, adding that given the normal fluctuation of economic data, it will be difficult for forecasters to determine whether the economy

has strayed from the sustainable growth path assumed in the Control forecast, onto the boom-bust path which leads to a recession until early 1998.

Under current law Minnesota will have only a \$270 million budget reserve for the 1998-99 biennium. The Council continues to believe a reserve of at least \$500 million in addition to the funds necessary for the state to meet its cash flow needs would be prudent. Minnesota's current budget reserve is only about 1.4 percent of projected biennial expenditures. That is well below the long term standard of 5 percent recommended for the state following the financial problems Minnesota faced during the early 1980s.

ECONOMIC OUTLOOK

Most forecasters were surprised by the economy's spring rebound. Unexpected household and federal spending were largely responsible, with business capital outlays also contributing. Consumers ignored rising mortgage rates and mounting debt to buy new homes and autos. Federal spending surged once the shutdown ended. Business investment in computers was especially strong even though other capital spending weakened.

In the second quarter, real GDP rose at a 4.7 percent annual rate, slightly more than double the first quarter pace. This robust expansion clearly strained capacity, raising concerns of renewed inflation. For the first time, anecdotes of labor market tightness were echoed in a modest pickup in wages. Higher wages helped employers hire more workers. The unemployment rate dropped from 5.6 percent in March to 5.2 percent in October. This is significantly below DRI's 5.9 percent estimate of the non-accelerating inflation rate of unemployment (NAIRU), the minimum the economy will tolerate over an extended period without accelerating inflation from rising wages.

News that third quarter real GDP growth slowed to a more sustainable 2.2 percent was welcomed despite especially weak consumer spending which rose only 0.4 percent. Economists were relieved because the upturn in wages convinced many the economy had reached the edge of accelerating inflation with no response from the Federal Reserve in sight. Unprecedented leaks to the media indicated the Fed's Open Market Committee had been sharply divided over whether a pre-emptive interest rate increase was needed to slow expanding demand for goods and services before prices begin to rise faster. Economists now generally agree rates should rise, but most tend to doubt drastic Fed action is required. DRI predicts there will be only two modest 25 basis point rate increases in 1997 because budget constraints are restraining federal outlays, and because market driven interest rate increases early this year are moderating consumer spending.

While the outlook is more favorable than it has been in years, Finance Department economists think media reports of an end to the business cycle are greatly exaggerated. Analysts are still doing business cycle analysis. Forecasters predict currently stagnant consumer spending will rebound by Christmas because of favorable household fundamentals and the absence of Federal Reserve intervention. Continued jobs and income growth, strong consumer confidence, and the fact that no monetary tightening is currently working its way through the system are critical factors in most economists' now very sanguine view of prospects for 1997 and 1998.

Barring some unfavorable domestic or international event or an error on the part of the Federal Reserve, DRI believes there is little possibility for a recession before 1999 or 2000. Their November Control strains credibility by calling for 2.4 percent real GDP growth in 1997 and 1998, a rate slightly above the approximately 2.0

percent widely considered sustainable without accelerating inflation. Currently, renewed inflation seems the major risk to the economy because it could destabilize the financial markets or provoke the Fed to raise interest rates excessively. DRI recognizes this possibility in an alternative boom-bust scenario with a recession in 1999.

Why Worry About Inflation?

Few observers are worried about the modest, stable 3.0 percent per year consumer inflation of the past few years. Rather, the concern is that price increases will pick up enough to seriously distort economic decisions, as happened during the double digit inflation episodes of the 1970's and early 1980's. Consequently, financial markets and the Fed remain on an inflation watch. Accelerating inflation creates a major uncertainty for financial markets because investors seek to build an inflation premium into interest rates to protect the real value of their assets. Economists inside and outside the Federal Reserve are concerned that rising inflation would encourage consumers to beat future price increases by accelerating purchases, cutting the savings and investment needed to generate future GDP growth. Over time, even small reductions in capital formation can compound into surprisingly large losses in potential GDP and household income.

While many analysts believe excessive long term money supply expansion is inflation's root cause, living costs and the cost of doing business are considered possible near term sources of an imminent acceleration in prices. The worst post-war inflationary episode beginning in the late 1970's was preceded by a rapid runup in food and energy prices which seems unlikely to be repeated soon. Because labor markets are currently tight, the focus now is on labor compensation which is about two thirds of all costs in the economy. In the near future, economists generally consider wage increases in excess of productivity gains to be the most likely source of accelerating inflation. Wages or benefits, or both, rise when employers have difficulty hiring qualified workers to meet growing demand. Wage increases in excess of productivity improvements raise unit costs which firms pass on as higher prices. The currently low unemployment rate is significant because it is accompanied by labor market tightness like that which drove up labor costs and prices in the late 1980's.

A recent U.S. Department of Labor report indicates unit labor costs are beginning to increase, causing some economists to suggest price increases cannot be far behind. Once prices start to rise, the best opportunity to cool the economy is gone because individuals seeking to maintain their living standards will almost immediately raise their expectations for future inflation. Even if interest rates belatedly rise enough to slow the economy and drive unemployment back up to the NAIRU, higher inflation will persist because workers will demand wages to match anticipated price increases. Only at unemployment rates above the NAIRU will labor market slack make it impossible to get raises large enough to cover expected increases in living costs. Competition then ensures that firms pass on smaller cost increases, causing

What is the NAIRU?

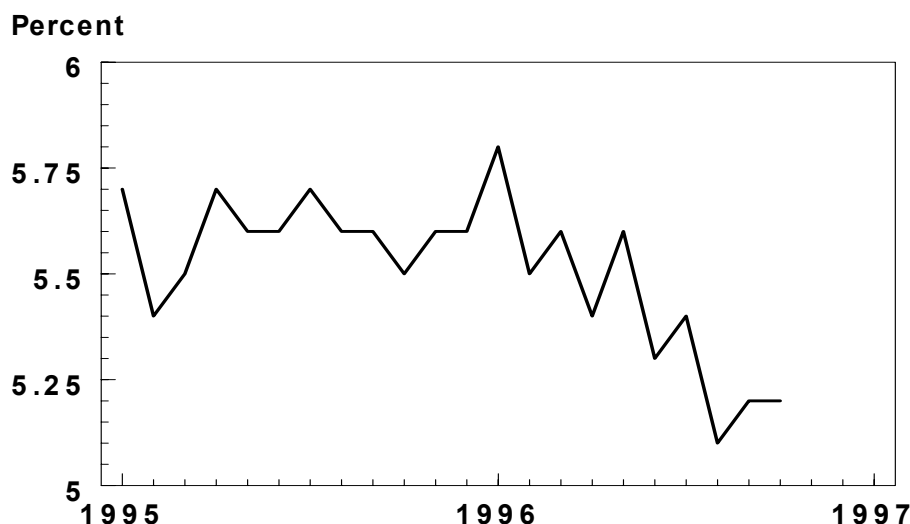
The NAIRU is defined as the unemployment rate at which the labor market generates no upward or downward pressure on the inflation rate, at the current trend rate of growth in productivity. Below the NAIRU threshold, the economy can supply additional goods and services only if prices rise faster. At unemployment rates below the NAIRU, labor shortages force employers to raise wages above productivity gains in order to attract workers needed produce more output. Wage increases in excess of productivity improvements raise unit costs. Strong demand like that now present in the economy allows firms to pass on additional costs by raising prices to consumers.

expectations of future inflation to decline. All this takes time, though, because risk averse workers moderate their inflation expectations more slowly than they raise them, making deflation a more drawn out and painful affair than inflation.

The Fed's Dilemma

In the best of circumstances, fine tuning the economy is a tricky job. During the summer, unprecedented media leaks indicating sharp divisions within the Federal Reserve Open Market Committee reflected difficult choices in judging the magnitude and timing of interest rate moves. All the Fed directly controls are short term rates which have only modest impacts on consumer spending and on business demand for inventories and capital goods. Both DRI and internal Fed studies discussed by former Vice Chairman Alan Blinder in a Federal Reserve Bank of Minneapolis publication indicate these impacts take up to two years to fully develop. Since the response is slow and weak, proper timing requires anticipating price increases far enough in advance to give higher interest rates the lead time needed to cool growth in demand for goods and services. Unfortunately, economic forecasting is so inexact the Fed has only a few successes to its credit among many attempts. A failure can leave inflation unchecked, or possibly worse, cause or contribute to a recession. Many analysts think excessive tightening in the late 1980's contributed to the 1990-1991 recession although most believe the Persian Gulf War precipitated it.

U.S. Unemployment Rate (Seasonally Adjusted)



The U.S. employment rate plunged as real GDP surged early this year, raising fears of accelerating inflation from rising wages.

How Fast Can The Economy Grow Without Renewed Inflation?

Virtually all mainstream forecasts for the U.S. economy are based on analyses showing that in the long term real output as measured by GDP adjusted for price changes can increase about 2.0 percent annually with stable inflation. Potential GDP growth of 2.0 percent is estimated as approximately the sum of labor force expansion at 1.0 percent per year and output per worker or labor productivity gains which DRI expects to average slightly more than 1.0 percent annually for the next several years.

Few analysts would question DRI's labor force assumption, but productivity growth is currently the subject of considerable debate. Data for the last few years suggest 1.0 percent annual productivity improvement may be optimistic. Between 1992 and 1995, output per hour rose only 0.1 percent annually. For the first three quarters of 1996, it averaged only 0.5 percent at an annual rate, with only a 0.2 percent increase in the third quarter. DRI contends that after adjustment for what they call cyclical effects in employment growth, third quarter productivity rose 1.1 percent at an annual rate. They also suggest the next revision of the National Income and Product accounts could raise output estimates, which would increase 1992-1995 productivity gains.

Real GDP growth at approximately 2.0 percent is just enough to utilize productivity improvements plus an additional number of workers equal to labor force expansion,

leaving the unemployment rate unchanged. If GDP rises faster, the unemployment rate declines because more workers are needed than can be supplied by the labor force. In a tight labor market like the one at present, workers tend to hold out for higher wages which employers able to raise prices will pay. Econometric analyses indicate that at unemployment rates below about 5.9 percent, available qualified workers are often so scarce employers must offer wage increases in excess of productivity gains. For this reason, DRI considers approximately 5.9 percent to be the non-accelerating inflation rate of unemployment (NAIRU). Other analysts get slightly different results, but virtually all NAIRU estimates fall in the 5.5 to 6.0 percent range.

Estimates of the NAIRU are open to question because the data used is not very accurate and because even an accurate unemployment rate is a crude indicator of labor market tightness. But recent experience supports the statistical evidence. When real GDP grows at about 2.0 percent, the unemployment rate tends to hover between 5.5 and 6.0 percent and unit labor costs remain stable. During the second quarter, real GDP soared at a 4.7 percent annual rate with almost exactly the expected consequences. Wage increases soon accelerated and the unemployment rate began a sharp decline.

The Growth Controversy

Convincing evidence that higher real GDP growth is sustainable with stable unemployment and inflation would almost certainly cause DRI and most other analysts to raise their forecasts. In the view of Finance Department economists, there would be little choice because bond markets would be less likely to raise long term interest rates on news of economic strength and the Federal Reserve would probably adopt a looser monetary policy. The Fed's cooperation may not be absolutely necessary since a flatter yield curve alone would significantly reduce the cost of financing additional productive capacity needed for faster growth.

During the past several months, a few analysts have contended that real GDP could expand in the 3.0-3.5 percent range because the NAIRU is much less than currently estimated. They argue that productivity is growing faster than available data indicate, partly on the basis of anecdotes from the business community. If true, the economy is less inflation prone than generally believed because more output is available from the labor force at existing wages, so GDP could expand faster without accelerating inflation. Unfortunately the Federal Reserve and the financial markets, the argument goes, accept the 2.0 percent potential growth consensus without question and so they raise both short and long term rates to dampen GDP expansion whenever it seems likely to rise above the trend. In the view of the dissenting analysts, the unwarranted, low estimate of sustainable growth is thus handicapping the Nation's economy at great cost in lost output and lower living standards.

In reply, MIT economist Paul Krugman in a September Minneapolis Star-Tribune article points out that productivity and output are based on the same data. If productivity is really higher than the data suggest, then so is output by a corresponding amount. There may be output not accounted for in GDP but there is no reason to think it is not reflected in current prices and unemployment rates, so there is no known error in measuring the NAIRU. At 2.0 percent, measured potential real GDP growth may be understated, but since any unobserved production is available for use, there is no loss in living standards.

Consumption

For some time, economists have predicted consumers would retrench modestly in order to save more because aging baby boomers need to put away for retirement. Last year's spending dip was widely taken as a sign that the time for more saving had arrived. Saving did increase, so economists were surprised when consumer's desire to spend surged early this year.

As a result of this experience, DRI and other forecasters have raised their predictions for consumer spending while dismissing recently released data indicating another slowdown. A Business Week article shows third quarter retail sales growth to be even less than the dismal outcome in 1995's last quarter which raised fears of a recession. The third quarter GDP report released October 30 shows real consumer spending rising only 0.4 percent at an annual rate, the slowest in five years. In September, consumer credit outstanding declined for the first time in three years. But analysts generally believe the current slowdown is temporary and that the coming Christmas retail season, while not great, will be much better than last year. Consequently, a consumer led recession in 1997 is thought to be very unlikely.

Finance Department economists believe that currently unstable consumer behavior indicates there is a risk something could go wrong which DRI and others may be underestimating. The need for more saving which many were convinced was so important a year ago is based on demographic fundamentals while the early 1996 surge in household spending is attributable to more jobs, higher incomes, and stock market driven gains in wealth, all of which are quickly reversible. Also, very little attention is being paid to record levels of bankruptcies and credit card indebtedness which indicate many households are having financial difficulty. September's decline in credit outstanding may mean consumers are just resting before starting their Christmas shopping, but it could also indicate much more cautious spending in the future.

Investment

Like consumer spending, investment in housing, inventories, and computers has given the economy an unexpected boost during 1996. Housing has become more resistant to mortgage rates above 8.0 percent. Excessive inventories sold out quickly early in the year and firms promptly began restocking. Computer sales to

business held up well as spending for plant and other equipment slowed. The computer industry is now almost as important as the auto industry in the economy's cyclical swings. Recently, Business Week reported that spending for computers is approaching 3.0 percent of GDP, compared to 3.5 percent for cars and light trucks.

Many analysts are convinced variable rate mortgages together with readily available refinancing have rendered the housing market less interest rate sensitive than it once was. Despite rising mortgage rates, demand for new and existing housing has been strong all year. Sales of new homes are setting records, reaching their highest annual rate since 1986 in August. In September, monthly sales weakened slightly but still exceeded 700,000 units for the ninth consecutive month, the longest period at this rate since the late 1970's when soaring inflation was driving real estate speculation. There is no observable acceleration in inflation now, and there is no evidence inflationary expectations are rising, so DRI's only explanation is that strong confidence is currently a significant factor in demand for homes. Other economists, though, are sharply divided as to whether confidence plays an important role in spending decisions, so DRI may be overlooking something which could cause an unexpected downturn in the future.

Strong demand for goods has cleared out excess inventories left over from 1995. In addition, auto inventories were significantly depleted by the General Motors strike in March. Firms are now restocking, so rather than being a drag on the economy like last year, inventory accumulation is contributing to real GDP growth. A good Christmas retail season will ensure continued inventory rebuilding and improve the outlook for 1997.

Real business computer spending which surged at nearly a 50 percent annual rate early in the year is waning, but DRI predicts it will continue to grow at rates in the teens. Spending for other equipment and for structures will get considerably weaker. Capacity now appears to have caught up with output, so only relatively modest additions are needed as GDP expands.

Government

Practically everyone underestimated the surge in federal spending once the shutdown ended. DRI reports nominal defense spending, which was primarily responsible, doubled in March from shutdown levels. Still more stimulus came in the second quarter when total real spending rose 9.4 percent at an annual rate, up from 6.0 percent the previous quarter. That, however, was the end as budget constraints took over. Real spending declined 3.9 percent in the third quarter and DRI expects it to slip another 4.7 percent in the fourth. In the November Control, real Federal spending continues to decline in every year to the end of the forecast horizon. Reduced defense outlays will account for the largest part of the cutback, but 1997's 2.0 percent reduction will be the smallest since the Persian Gulf War. Non-defense spending will also erode, but more slowly.

DRI assumes spending reductions will be achieved with various economies rather than with major program cuts not yet enacted. It appears the election's outcome will not significantly change their assumptions for federal outlays which represent a compromise between budget balance by 2002 and a Congressional Budget Office projection which adjusts discretionary spending for inflation.

International

The third quarter's sharp increase in the trade deficit helped hold inflation in check by diverting demand overseas. Imports of goods in strong demand including oil, autos and parts, and computers rose significantly. At the same time, exports declined, though much of this was highly volatile aircraft shipments. Longstanding trade deficits with Japan, China, and Western Europe were left unchanged or worsened.

Although foreign trade helped moderate the economy at an appropriate time, the chronic U.S. trade deficit represents a serious downside risk in the event other sectors weaken. DRI expects the deficit to grow steadily at least through 1998, leaving more dollars in foreigners hands than they want to hold. Consequently, the dollar's exchange value will stop rising in 1997 and then decline steadily for several years. This will raise imported goods prices, adding to inflationary pressure.

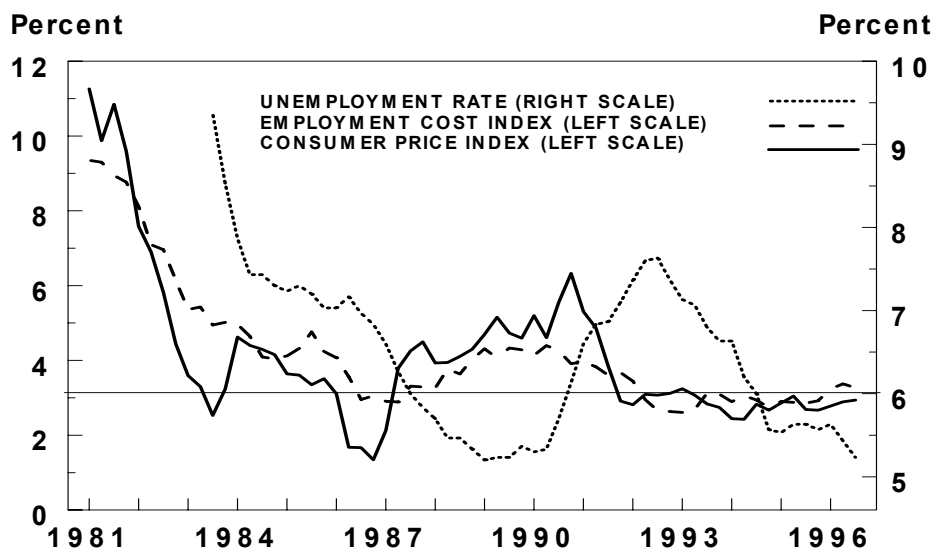
Monetary

After lowering short term interest rates last January, the Federal Reserve stayed on the sideline all during 1996 despite emerging signs of wage-driven inflation. In retrospect, Dr. Greenspan's steady course appears to have been all that was needed. Market driven increases in long term rates early in the year helped slow the economy in the third quarter, and inflation remained more subdued than declining unemployment and rising wages would suggest based on past experience.

The Fed's approach posed risks for 1996 but improved the outlook for 1997. For most of this year, speculation and uncertainty over the next interest rate increase caused significant volatility in the financial markets. Both the bond and stock markets often reacted sharply to small bits of news only to reverse themselves a few hours or days later. In July, the volatility intensified because the monetary tightening many expected did not occur and because second quarter growth in real GDP had surged beyond acceptable levels. For a while, it appeared uncertainty created by the gyrations would cause consumers and business firms to postpone spending decisions.

In 1996, the wages component of employment costs began to rise as the unemployment rate declined and labor markets tightened. There is, however, no statistical evidence that rising wages are being passed on through higher prices.

Employment Costs Rise As Unemployment Rate Declines



Some of the economy's recent slowdown may be attributable to that midsummer uncertainty, though fortunately the markets have calmed considerably. The outlook for next year is now much improved, because consumers and firms did not overreact last summer, and because there was no monetary tightening which would now be working its way through the system to surface with possibly unfavorable results in 1997.

Inflation

Economists are generally agreed there is virtually no evidence rising wages are leading to accelerating prices. By some measures, price increases are picking up a little while others show a slight slowing. DRI expects the consumer price index to edge up 3.0 percent in 1996, slightly more than 1995's 2.8 percent, primarily because of energy and food price increases which have already occurred. But the implicit GDP deflator is expected to increase only 2.0 percent, down from 2.5 percent in 1995. In the November Control, consumer prices rise 3.0 percent in 1997 while the GDP deflator increases 2.2 percent.

Neither the recently enacted federal minimum wage boost nor higher food prices will significantly raise the overall price level. DRI estimates each of these will add only 0.1 percentage point to consumer inflation in 1997 and 1998. While not contributing much to overall inflation, food prices will continue to rise in 1997 as impacts from 1996's temporary runup in grain prices work through the system.

Absence of an observable acceleration in prices does not mean the absence of inflationary pressure. When labor markets tightened, wages rose, and the

unemployment rate dropped as GDP growth accelerated in the second quarter. Currently, inflation is less than most economists would expect given the signs of inflationary pressure and strong demand for goods and services. DRI attributes this to two pieces of good luck. One is that fringe benefit costs have not accelerated, keeping total compensation costs in check even though wages have been rising. The other piece of luck is a rise in the value of the dollar which has restrained imported goods prices. DRI expects fringe benefit costs to begin rising faster and the value of the dollar to start a long decline in 1997, leaving the economy more exposed to inflationary forces than it has been in the past.

MINNESOTA OUTLOOK

Last February, the 1996 U.S. outlook was for a near-recessionary slowdown which was reflected in the forecast for Minnesota. Instead, the U.S. economy rebounded in the spring and the local economy benefited from the unexpected surge. As a result, estimated Minnesota and U.S. growth rates for 1996 have been revised upward by almost exactly corresponding amounts. Preliminary and still incomplete data indicate Minnesota non-farm employment should grow 2.1 percent in 1996, up from 1.5 percent forecast in February. Total wages and salaries should rise 6.3 percent, up from 4.5 percent in February's forecast. In comparison, the November Control predicts 1996 U.S. employment will rise 2.0 percent, up from 1.2 percent, while total wages will rise 5.9 percent, up from 4.4 percent forecast in the February Control.

Much of the change to the 1996 estimates comes from the springtime surge which was largely a one-time event. Consequently, the 1997 employment estimates have been revised very little. Minnesota jobs should increase 1.7 percent in 1997, up from 1.6 percent forecast in February while in the new Control U.S. employment is predicted to rise 1.6 percent, the same as forecast in February. As a result of the economy's unexpected 1996 strength, however, labor markets are tighter so wages are rising faster than forecast last February with some carryover into next year. For 1997, total Minnesota wages are predicted to rise 5.2 percent, up from 4.2 percent, while DRI expects U.S. wages will increase 5.4 percent, up from 4.6 percent forecast in the February Control. No attempt was made to adjust the Minnesota forecast for the new federal minimum wage because both the legislated wage increases and the number of workers involved are too small to materially affect the outlook.

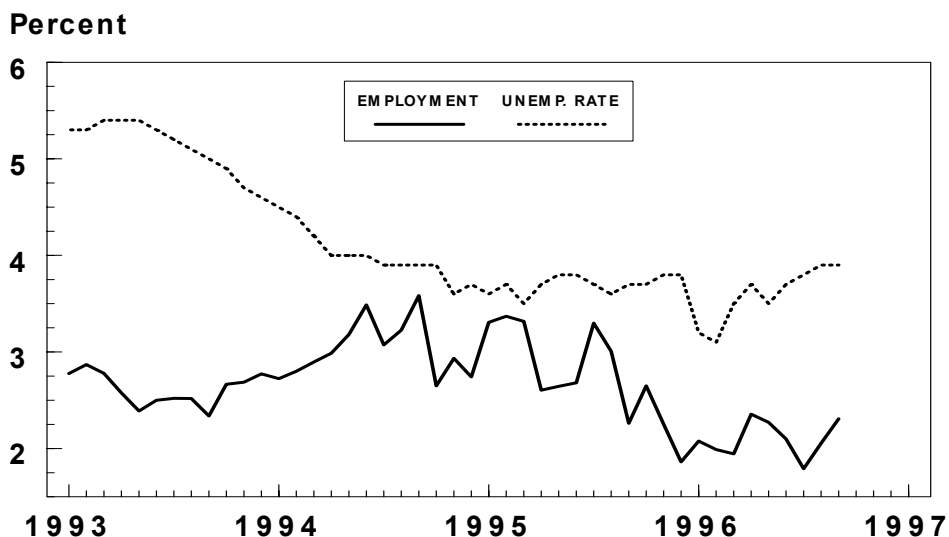
Risks To The Forecast

DRI's very sanguine view of the U.S. outlook does not completely carry over into the Minnesota forecast. Even if the November Control scenario for the U.S. economy comes true, a number of Minnesota specific risks will remain. Most of these are data problems which could change a future forecast depending on how they are resolved. There are also special risks associated with projecting an economy operating as close to capacity as Minnesota's appears to be. Unlike its U.S. counterpart, there is no simple or generally accepted way to calculate potential output as a means of judging how fast the local economy can grow.

Recent Minnesota Income Data Is Unsettled

Estimates of total wages paid in Minnesota in 1994, 1995, and 1996 are critical to the revenue forecast. Currently, the income tax simulation utilizes a sample of 1994 Minnesota income tax returns. To forecast revenues for 1996 and beyond, this tax information must be aged forward based on income data from 1994, 1995 and 1996.

Minnesota Employment Growth (Percent Change Over Previous Year) and Minnesota Unemployment Rate (Percent)



Declining jobs growth and a relatively stable unemployment rate in the presence of a strong U.S. economy may indicate labor market tightness is restraining Minnesota's expansion.

Thus, the revenue forecast really begins with an analysis of what has happened since the base year. Revisions to the income data can change future forecasts by moving the starting point. New data for 1994-1995 may also affect the forecast because it could lead to changes in the Finance Department model of the Minnesota economy which measures the relationship between employment and wages.

Minnesota wage data released by the U.S. Department of Commerce November 7, for 1994 and 1995, is not consistent with data on total wages provided by the Minnesota Department of Jobs and Training which Finance Department economists use to judge the quality of the official Commerce estimates. The new Commerce data seems of poorer quality than provided in the previous release last July. In the memory of Finance Department economists, this is the first time there has been apparent deterioration as the Commerce data is revised. Another release scheduled for late January or early February may resolve this problem. In this forecast, July estimates were relied on.

There are also some potential Commerce Department revisions to Minnesota portfolio income and non-farm proprietor's income which could have an impact on next November's forecast. Because of delays caused by last year's overhaul of the National Income and Product Accounts and the federal shutdown, national totals for portfolio income and non-farm proprietor's income were not revised on schedule. These totals serve as a benchmark for the corresponding state data which, therefore, was also not updated as usual. Provided new national data is released on

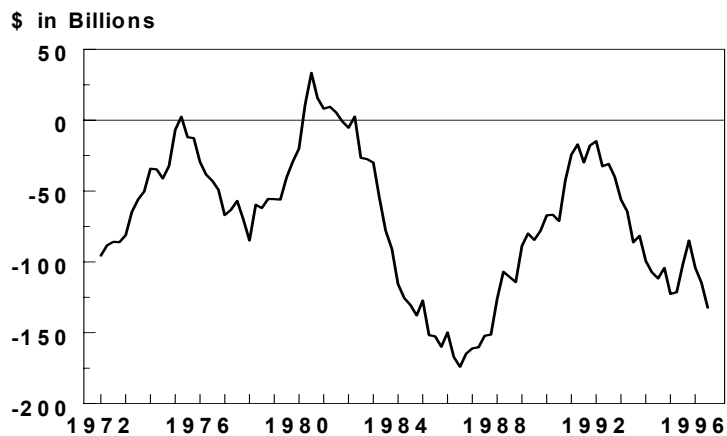
schedule in July, 1997, the corresponding Minnesota estimates for 1994, 1995, 1996 will be revised late next October or early November.

Minnesota's Expansion

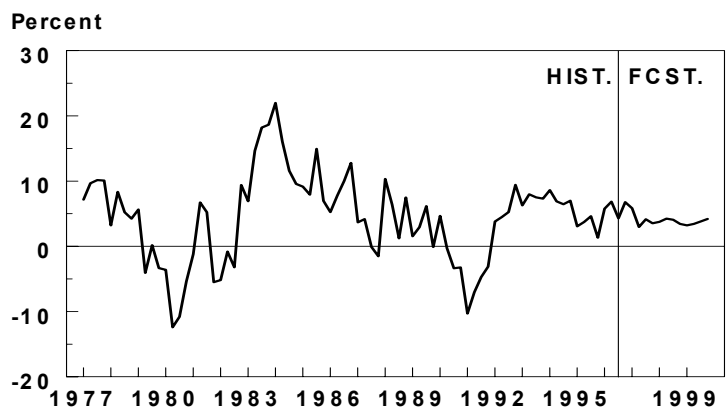
While there are many anecdotal reports, there is little statistical evidence Minnesota's economy is close to capacity. Some circumstantial indications come from examining jobs expansion and the unemployment rate. Minnesota employment growth has slowed significantly since mid-1995 despite a strong U.S. economy, possibly because the tight local labor market is restraining the economy. Unlike the U.S., Minnesota's unemployment rate did not follow the U.S. average and plunge when the economy surged earlier this year. Instead, it remained relatively stable suggesting the local economy is closer to capacity than its U.S. counterpart because there are relatively fewer workers willing or able to take unfilled jobs. Unfortunately, there is no generally accepted way to calculate output lost as a consequence, so there is no measure of how much the expansion is being restrained. This makes forecasts of the local economy subject to additional uncertainty not present when higher unemployment rates indicate labor resources are adequate to cover projected growth.

Selected National Economic Indicators

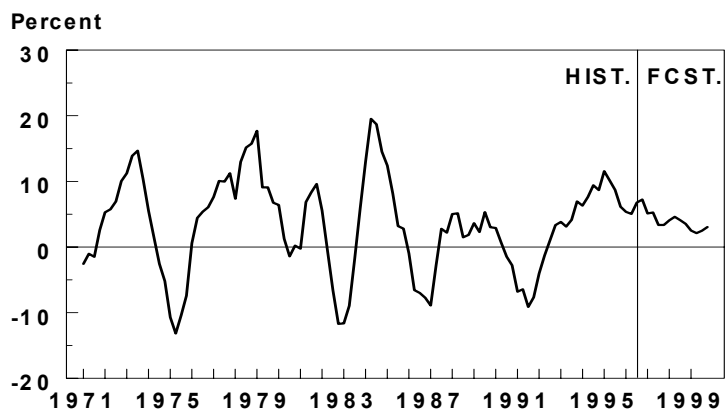
U.S. TRADE BALANCE (\$1992)



GROWTH IN REAL CONSUMER DURABLES SPENDING

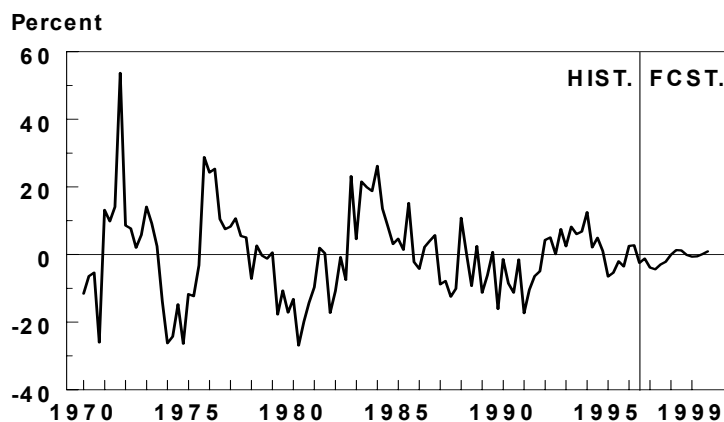


REAL BUSINESS INVESTMENT IN PLANT AND EQUIPMENT

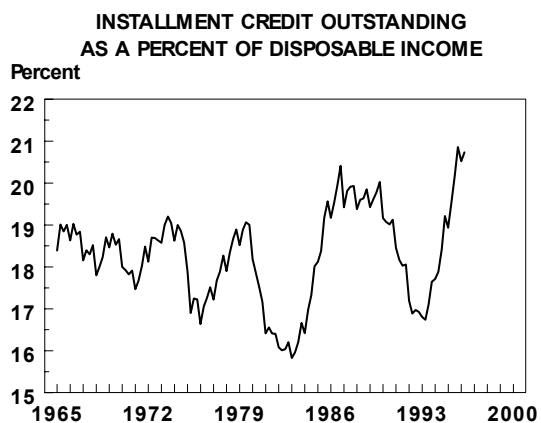


Selected National Economic Indicators

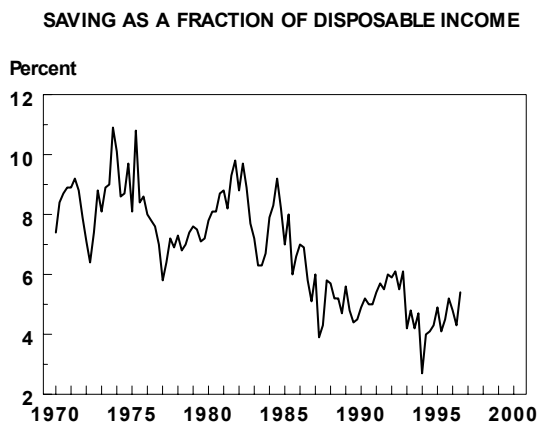
CHANGE IN CAR SALES PER JOB



CONSUMER CREDIT OUTSTANDING AS A PERCENT OF DISPOSABLE INCOME

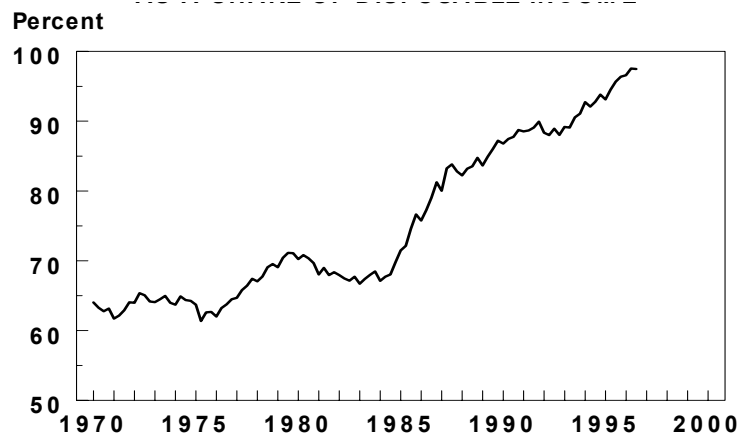


SAVING AS A FRACTION OF DISPOSABLE INCOME

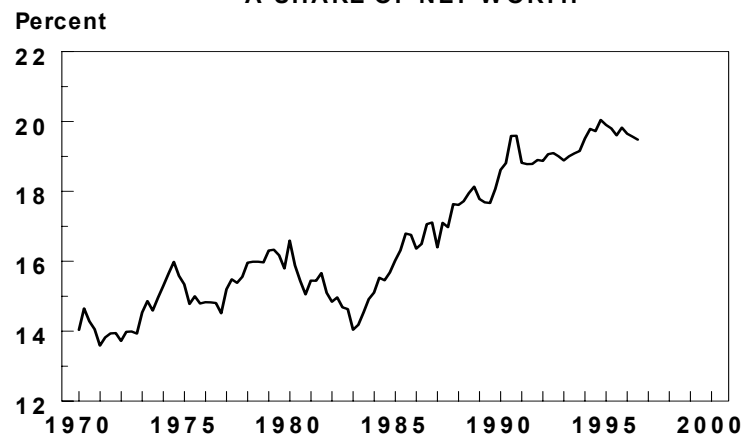


Selected National Economic Indicators

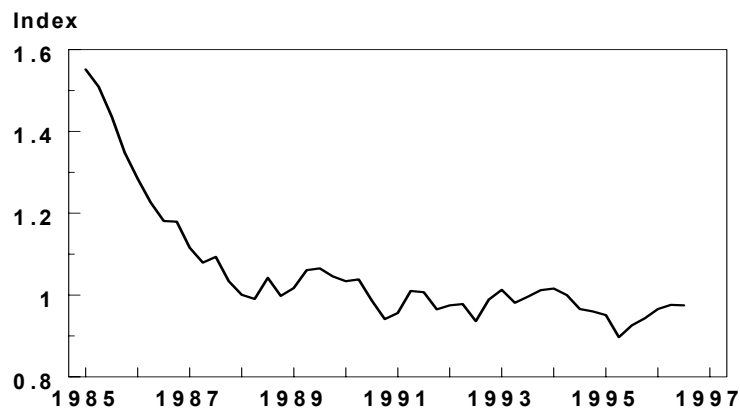
HOUSEHOLD FINANCIAL LIABILITIES
AS A SHARE OF DISPOSABLE INCOME



HOUSEHOLD FINANCIAL LIABILITIES
AS A SHARE OF NET WORTH



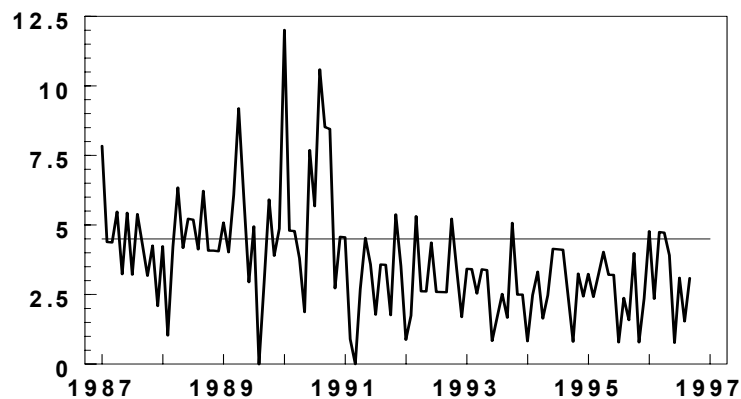
TRADE-WEIGHTED VALUE OF THE DOLLAR



Selected National Economic Indicators

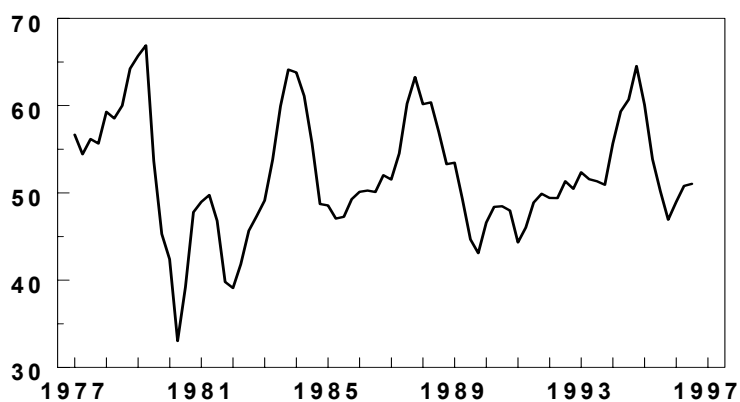
CONSUMER PRICE INDEX

Annualized rate (in percent)

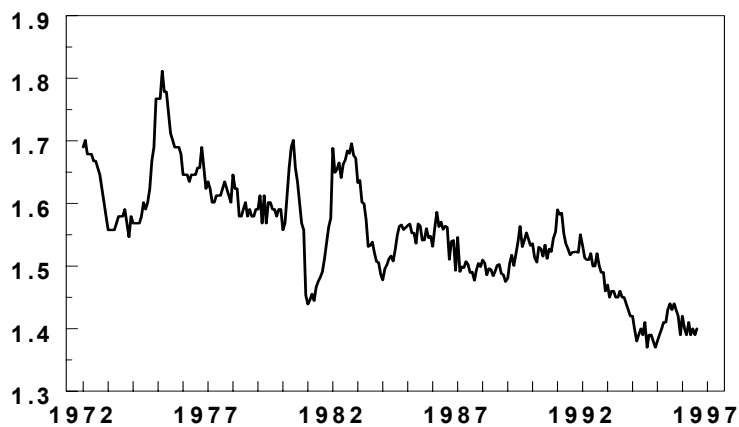


PROPORTION OF COMPANIES REPORTING SLOWER DELIVERIES

Percent



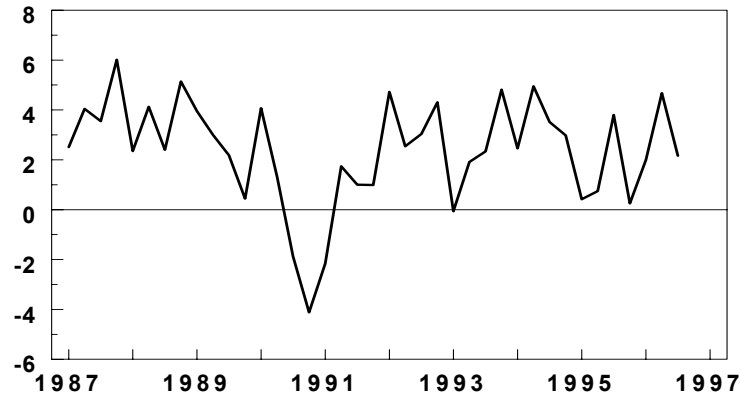
MANUFACTURING AND TRADE INVENTORY TO SALES RATIO



Selected National Economic Indicators

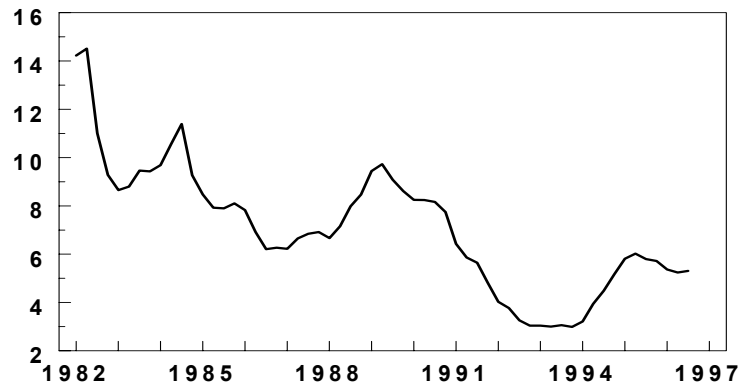
REAL GDP GROWTH

Annualized rate (in percent)



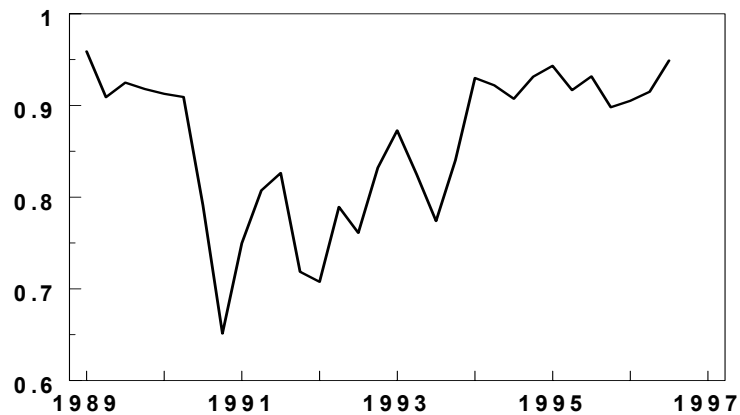
FEDERAL FUNDS RATE

Percent



INDEX OF CONSUMER SENTIMENT

index



FEDERAL BUDGET UPDATE

Short-term Deficits Down, But Long-term Up

DRI's estimates of annual federal deficits in the very short-term (1996) are below those anticipated last February, but are greater beyond 1996:

[\$ in Billions]	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Nov. 1996	-113	-131	-126	-108	-98	-100	-89	-83	-83	-86	-95	-112
Feb. 1996	-147	-121	-84	-65	-49	-51	-60	-57	-56	-58	-55	-39
Difference	+34	-10	-42	-43	-49	-49	-29	-26	-27	-28	-40	-73

Pressure on Congress to reduce the anticipated deficits will likely continue, and those actions will affect the economy and state and local government receipts. Some states will be affected more than others.

Minnesota's Economic Exposure is Limited

Fortunately, Minnesota's economy is not as dependent on federal payments as most states. In 1995, per capita federal payments to Minnesotans and their governments averaged nearly \$4,122, 20% below the U.S. average of \$4,800. Minnesota ranked 48th among the 50 states in the amount of federal payments received per capita. While the spending reductions will not be apportioned on a pro-rata basis, Minnesota has a smaller proportion of its economy at stake than the national average.

Slightly more than half of federal spending in Minnesota is direct payments to individuals. More than half of that spending is for social security and federal pensions, items where spending growth is not being constrained. Only Medicare expenditures, about 21 percent of this spending category, are likely to be subject to reductions.

Wages and salaries and direct federal procurement contracts are also a relatively small portion of the Minnesota economy. Federal wage and salary payments in Minnesota totaled a little more than \$1.5 billion in 1995, or \$361 per capita. The state ranked 46th in per capita wage and salary employment. While there will doubtless be additional federal jobs lost in the state, Minnesota's exposure is not as great as that of most states.

Similarly, federal purchases are also a small percentage of the state's economy. Defense procurement from Minnesota based companies totaled \$1.1 billion in 1995; non-defense, an additional \$0.5 billion. Minnesota ranked 36th on a per capita basis. Losses of federal contracts will have severe impacts on firms and individuals supplying goods and services to the federal government, but in a state economy

producing more than \$100 billion annually of goods and services, cuts to a \$1.5 billion sales base are unlikely to create any major economic dislocations.

Key Program Payments May Be Adversely Affected

Other expenditures, including agricultural program payments and research contracts are important to the state. Minnesota's status as a major farm state and a major research center cause the state to receive more than the national averages in these areas. However, per capita amounts, and thus the amount at risk for the state's economy is relatively small. For the short term at least, farm program payments have been fixed through 2002 by the 1996 farm bill. Future cuts in research funding, though, are of more concern. The University of Minnesota, Mayo clinic, and other institutions receive a significant amount of research funding from the federal government. Those resources, and the potential spin-off development of Minnesota's medical technology industry could be affected in future years.

State and Local Funding Impacts Remain Uncertain

The National Governor's Association and National Association of State Budget Officers have developed estimates of Minnesota's share of total budget authority for grant programs in federal fiscal year (FFY)1997 based on bills enacted through September, 1996. Total estimated budget authority for grants to Minnesota state and local government for FFY1997 is \$3.927 billion. This compares to \$3.837 billion for FFY96 and \$3.931 billion for FFY95. Information on major federal grants to Minnesota is summarized in the following table for FFY1993 to FFY1997. The specific programs listed in the table represent approximately \$3.5 billion, or 90% of total federal grants to Minnesota state and local governments.

Federal Funds in Minnesota, 1993-97						
Group/Program Name [\$ in Millions]	1993 Actual Budget Auth.	1994 Actual Budget Auth.	1995 Actual Budget Auth.	1996 Actual Budget Auth.	FFY Est. Budget Auth.	1997 % of Funds in Group
Grants Flowing Through the State Treasury or Managed By The State						
Medicaid- Benefits, Admin, & Training	1,287	1,421	1,566	1,659	1,773	50.6%
Food Stamp Program- Benefits & Administration	259	264	271	256	260	7.42%
Federal Highway Aid	275	261	322	264	259	7.39%
AFDC/TANF- Benefits and Administration	225	230	224	207	206	5.88%
Child Nutrition- Benefits & Administration	136	154	152	160	175	4.99%
Compensatory Education	79	82	85	84	89	2.54%
Education of the Handicapped	43	48	52	52	65	1.86%
Child Support Enforcement Administration	35	45	53	48	50	1.43%
Foster Care	31	36	34	40	49	1.39%
WIC-Supplemental Feeding Program	39	41	43	45	48	1.37%
Social Services Block Grant	49	47	49	41	44	1.24%
Low Income Home Energy Assistance	26	56	51	42	39	1.10%
Rehabilitation Services-Basic State Grant	33	34	35	36	36	1.03%
Unemployment Insurance	35	35	36	31	31	.89%
Community Development Block Grant	23	25	26	26	25	.72%
Other Federal Grants to the State	384	408	386	361	355	10.12%
Subtotal- Federal Grants to/managed by State Treasury	2,960	3,186	3,382	3,352	3,504	100.0%
Grants Paid Directly to Local Governments						
Subsidized Housing	165	177	213	165	78	29.56%
Community Development Block Grant-Entitlement	41	45	48	47	46	17.44%
Head Start	31	37	38	40	44	16.48%
Operation of Low Income Housing	22	23	30	29	30	11.19%
FTA-Section 9 Formula Grants	14	21	22	19	19	7.33%
Home Investment Local Grants	7	9	10	10	10	3.76%
FTA- Section 3 Discretionary Grants	0	11	12	8	8	2.99%
Other Local	34	36	40	29	30	11.25%
Subtotal-Local	315	359	413	346	264	100.00%
Other Grants						
PELL Grants	128	101	91	97	107	67.13%
College Work Study	15	14	14	14	19	11.74%
Supplemental Education Opportunity Grants	15	14	14	14	14	9.03%
Corporation for Public Broadcasting	7	6	6	6	13	8.43%
Other Grants to Other	14	14	11	8	6	3.68%
Subtotal-Other	178	149	137	139	159	100.00%
Total	3,454	3,694	3,932	3,837	3,927	

Programs for which Minnesota's budget authority in FFY97 is estimated to be less than FFY1993 are roughly \$680 million or 75 percent of the FFY93 authority. Some of the larger programs experiencing decreases since FFY1993 are shown in the table below:

Federal Program	FFY1997 Drop from FFY 1993 [\$ in Millions]	Percentage Change
Highway Aid	\$16	-5.72%
Social Services Block Grant	\$5	-10.96%
EPA-Wastewater SRF Grants	\$24	-68.36%
Job Training Partnership Act Programs	\$11	-37.12%
Subsidized Housing	\$87	-52.78%
Coop State Research	\$4	-42.19%
Energy Conservation-Weatherization	\$4	-40.59%
Magnet Schools	\$3	-100.00%
Community Prevention Partnerships	\$2	-100.00%
Math & Science Education	\$3	-100.00%
Emergency Food Assistance & Commodity Supplement	\$3	-40.86%
Education Improvement-Ch 2	\$2	-27.49%
EPA-Air Pollution Control	\$2	-76.19%
National Foundation for the Arts	\$1	-100.00%
Community Health Centers	\$3	-100.00%

Uncertainty Requires Careful Management Planning

All state agencies have been advised by the Department of Finance, as part of the biennial budget process, to develop strategies for dealing with federal reductions without replacing lost monies from state sources.

Compared to FFY1996, federal actions will produce no catastrophic financing changes in 1996-97. Only a few programs were cut from previous year levels, and most do not directly impact the state budget. The largest change was the replacement of Aid to Families with Dependent Children (AFDC) with Temporary Assistance for Needy Families (TANF), but current projections through 1999 do not show significant revenue losses. Seven year projections show TANF funding lower than the old law AFDC program, but enacted increases for the child care program will provide Minnesota with a partial offset to this loss.

There remains a strong possibility of further funding reductions in state fiscal year 1998 and beyond. Because of its size, a slowing in the rate of growth of Medicaid, the state's single largest source of federal funds, may have to occur if the federal deficit is to be reduced without significantly gutting other domestic grant programs. As the table above shows, most of the significant reductions over the past four years have occurred in domestic discretionary grants. In the reductions enacted in the last year, non-health care funding was cut slightly more than anticipated. More significant reductions in these programs will have to occur if Social Security, Medicare, Medicaid, and Defense are left off the table.

The table below shows the major federal aids coming to state or local governments for which Minnesota's budget authority in FFY97 is estimated to be less than FFY1996 budget authority.

Federal Program	FFY1997 Drop from FFY 1996 [\$ in Millions]	Percent Change
Highway Aid	\$ 5	-1.89%
Low Income Home Energy Assistance ¹	3	-7.14%
EPA-Wastewater SRF Grants	26	-70.27%
Fish & Wildlife Programs	3	-23.08%
Subsidized Housing	87	-52.78%
Agricultural Conservation	3	-100.00%
National Foundation for the Humanities	1	-100.00%
Other	8	varies
Total	\$138	

While the reductions shown for these programs present significant immediate planning challenges, state and local government agencies must keep in mind that the federal balanced budget proposals have always assumed large savings beginning in FFY 2000 and beyond. The implication is that the hardest cuts are yet to come. The Department of Finance will continue working with agencies to monitor federal proposals for both short and long-range impacts.

¹ Laws 1996 provided a \$9 million from the state Budget Reserve to moderate the effects on low-income Minnesotans of federal reductions to the Low Income Home Energy Assistance program.

F.Y. 1996-97 BUDGET STATUS

November 1996 Forecast

Revenues for the current biennium are now expected to be \$19.099 billion. This is an increase of \$646 million (3.5 percent) from estimates at the end of the 1996 legislative session. State expenditures for F.Y. 1996-97 are now expected to be \$18.644 billion, a net reduction of \$209 million from prior estimates.

These positive revenue and expenditure forecast changes are, in part, offset by a \$63 million change attributed to a reduction in the Budget Reserve amount and changes in the treatment of dedicated revenue account balances. The result is a \$792 million improvement in the forecast, increasing the balance expected for the end of the biennium to \$793 million.

However, two current law provisions reduce the available forecast balance. The first provides that \$114 million be set aside in a new School Aid Reserve account in F.Y. 1997. The second specified that, if a sufficient balance is forecast, the current school payment schedule which is split between state fiscal years, be adjusted from 85-15% to 90-10%. This results in a \$157 million one-time increase state expenditures in F.Y. 1997.

November 1996 Forecast Changes (\$ in Millions)

	Enacted May 96	November Forecast	Change
Beginning Balance (Excluding Reserves)	\$401	\$338	\$(63)
Revenues	18,453	19,099	646
Expenditures	18,853	18,644	(209)
Forecast Balance	\$ 1	\$793	\$792
Less: New School Aid Reserve	---	(114)	
Less: School payment change	---	(157)	
<i>Available Balance</i>	<i>\$ 1</i>	<i>\$522</i>	
Budget Reserve	\$270	\$261	

1996-97 Revenue Forecast

Current general fund resources for the 1996-97 biennium are now expected to total \$19.099 billion, \$646 million (3.5 percent) more than end of session estimates. Nearly all of the increase is attributable to additional growth in the four major taxes. Increases in other tax and non tax revenues, including investment income, were largely offset by decreases in transfers and prior adjustments.

Revenues from the four major taxes are forecast to be \$16.575 billion during the 1996-97 biennium, an increase of \$598 million over the previous forecast.

More than 70 percent of the additional revenue from the major taxes came from the individual income tax. Individual income tax receipts are now expected to exceed February's projections by 5.3 percent. The motor vehicle excise tax forecast increased by 5.4 percent. Forecasts for sales tax revenues and corporate income tax receipts increased by 1.4 percent and 3.9 percent respectively.

F.Y. 1996-97 Revenue Forecast (\$ in Millions)

	<u>FY94-95 Biennium</u>	<u>FY 96</u>	<u>FY 97</u>	<u>FY96-97 Biennium</u>
Revenues				
Individual Income Tax	7,293	4,135	4,377	8,512
Sales Tax	5,245	2,901	3,029	5,930
Corporate Income Tax	1,218	702	675	1,377
Motor Vehicle Excise Tax	<u>681</u>	<u>381</u>	<u>375</u>	<u>756</u>
Four Major Taxes	14,437	8,119	8,456	16,575
Other Revenues	<u>2,138</u>	<u>869</u>	<u>886</u>	<u>1,755</u>
Net Non-dedicated Revenue	16,575	8,988	9,342	18,330
Other Resources	<u>309</u>	<u>413</u>	<u>356</u>	<u>769</u>
Current Resources	<u>16,884</u>	<u>9,401</u>	<u>9,698</u>	<u>19,099</u>

Net non-dedicated revenues for 1996-97 are now forecast to grow by 10.6 percent over 1994-95, adjusted for the transfer of revenues to the Cambridge settlement fund. Income tax receipts in the current biennium are now expected to be 16.7 percent more than in the 1994-95 biennium due in part to one-time events. Net sales tax revenue is forecast to exceed 1994-95 levels by 13.1 percent.

Individual Income Tax

Individual income tax receipts for the 1996-97 biennium are now forecast to reach \$8.512 billion, up \$427 million from end of session estimates.

Nearly \$150 million of the additional revenue was received during the 1996 fiscal year and is already in the state treasury. Higher than expected tax year 1995 settle-up payments coupled with lower than anticipated refunds added \$90 million to F.Y 1996 receipts. Tax year 1995 liabilities substantially exceeded forecasts in most states, and at the federal level as well. Sources of the additional income cannot be identified until early 1997, after the annual sample of Minnesota tax returns is available for analysis.

Higher levels of capital gains income, particularly mutual fund distributions, have been widely suggested as the principal source of the additional income. Additional capital gains growth was added to the forecast. While this is likely to be part of the explanation of the higher than expected liability in 1995, past capital gains distributions from mutual funds have been less than 10 percent of total capital gains, so other types of income must also have been affected. Finance Department economists will examine changes in the sources of income carefully when the sample of 1995 tax filers is complete in January.

Preliminary federal return data suggest that some of the additional 1995 revenue is attributable to higher interest income. The remainder appears due to stronger than projected state economic growth. Total wages and salaries are now believed to have grown at an average rate of 7.3 percent during fiscal 1996, nearly 50 percent faster than forecast in February. While much of that additional growth came last spring, too late to have a major influence on fiscal 1996 receipts, it does significantly raise the wage base for F.Y. 1997.

Income tax revenue in fiscal 1997 is now forecast at \$4.377 billion, \$278 million more than previously expected. About 60 percent of the additional revenue appears to be due to permanent growth in the state tax base, the remainder by unusual, one time events. Prices and average yields for corn, wheat, and soybeans were high during 1996, adding substantially to farm income. Farm income will also be boosted by additional federal farm program payments made possible under the 1996 farm bill. Merger and acquisition activity involving several major Minnesota firms also is expected to have a material impact on state revenues during the current fiscal year.

Receipts from fiduciary returns, while only a small part of total collections, were substantially above historical levels. The forecast assumes that growth rates return to more normal levels in 1996 and 1997.

Withholding receipts and individual estimated tax payments were strong during the first quarter of the current fiscal year. Monthly variances for

November, December, and January will be monitored carefully for changes in payment patterns.

Replacing the 1993 income tax sample with a sample 1994 filers created no material change in the forecast of tax liability.

Sales Tax

The forecast for sales tax revenues increased only modestly over end of session estimates. Sales taxes are now expected to total \$5.930 billion during the 1996-97 biennium, \$80 million (1.4 percent) more than previously anticipated. Fiscal 1996 revenues were raised by \$29 million, consistent with final collections and refunds. In fiscal 1997, gross revenues were increased by \$76 million, but sales tax refunds increased by \$24 million, resulting in a \$52 million increase.

Sales of capital equipment, a key component of Minnesota's sales tax base, are now forecast to grow at an annual rate of 3.6 percent in fiscal 1997, nearly double the growth forecast in February. The \$4.4 million negative variance for the first four months of fiscal 1997 was included in the forecast.

Corporate Income Tax

Net corporate income tax receipts are now estimated to reach \$1.377 billion during the 1996-97 biennium, up \$51 million (3.9 percent) from end of session estimates. Slightly stronger growth in DRI's forecast of before tax, U.S. corporate profits explain the growth in revenues.

This forecast of the corporate income tax is based on DRI's estimates of pre-tax corporate profits, not the checking equation results which have been relied on in recent years because the two methodologies now give approximately the same results. The checking equation will still be available to be used to independently evaluate the level of the DRI corporate profits forecast. There now are a sufficient number of quarterly observations of corporate estimated tax payments following the major revisions of the corporate tax in 1987 to re-estimate the forecasting model. The corporate income tax remains the most volatile of all Minnesota's major revenues.

Corporate refunds required by the Cambridge Bank decision are treated as expenditures from the Cambridge Settlement Fund, not netted against current corporate income tax receipts. A total of \$166 million in Cambridge related refunds have now been paid, about 75 percent of current estimates of total liability.

Motor Vehicle Excise Tax

Motor vehicle excise taxes are now forecast at \$756 million for the 1996-97 biennium, \$38 million more than end of session estimates. Nearly \$22 million of the increase over the previous forecast occurred in fiscal 1996. The \$15 million positive variance for the first four months of fiscal 1997 has also been incorporated in the forecast. The outlook for auto and light truck sales in the November DRI Control is quite similar to February's. Light vehicle sales are expected to continue at an annual rate slightly in excess of 15 million units per year through the end of the biennium.

Other Revenues

Other tax and non tax revenues also add to the forecast. Tax and non tax revenues increase by \$71 million, but transfers, dedicated revenues and prior year adjustments fall by a total of \$23.2 million, leaving a net increase of \$48 million.

The forecast for investment income was increased by \$54 million, reflecting the larger cash balances indicated by the current forecast. Transfers from other funds were down \$74 million from forecast levels reflecting a change in the treatment of certain revenues in the Cambridge fund. It had no material effect on the ending balance.

Estimated inheritance and estate tax receipts are up from end of session estimates by \$16 million, and deed and mortgage taxes are up by \$5 million. Both changes reflect current collections rather than any changes which would carry forward to the future. All other revenue changes were small.

EXPENDITURE FORECAST F.Y. 1996-97 Biennium

Forecast expenditures for the F.Y. 1996-97 biennium total \$18.664 billion, \$209 million less than comparable estimates at the end of the 1996 legislative session. This change in total estimated spending reflects less than a 1.1 percent reduction from previous estimates.

Change in F.Y. 1996-97 Forecast Spending 1996 Session to November 1996 Forecast (\$ in Millions)

Estimated Spending	End of 96 Session	Nov. Forecast	Change
Education Finance	\$5,893.8	\$5,892.0	(1.8)
Property Tax Recognition	494.8	494.8	0
School Payment Change (90/10)	---	[156.7]	(156.7)
Post-Secondary Education	2,184.9	2,148.7	(36.2)
Local Aids & Credits	2,405.0	2,411.9	6.9
Other Major Local Assistance	832.1	861.2	29.1
Health Care	3,154.2	2,976.3	(177.9)
Family Support	500.9	488.9	(12.0)
State Operated Institutions	843.9	826.5	(17.4)
Legis., Judicial, Const. Offcs.	461.8	476.3	14.5
State Agencies' Operations & Grants	1,453.8	1,422.4	(31.4)
Debt Service & Other	446.9	438.9	(8.0)
Estimated Cancellations	(22.6)	(15.0)	7.6
Subtotal	18,649.5	18,422.9	(226.6)
Dedicated Expenditures	203.1	221.1	18.0
Total Expend. & Transfers	\$18,852.6	\$18,644.0	\$(208.6)

The table above summarizes only expenditure *forecast* changes. It displays, but does not include in totals, the \$156.7 million one-time increase in F.Y. 1997 in school district payment schedule changes. Giving effect to this provision increases total general fund spending for the biennium to \$18.8 billion.

Revised estimates for health care and family support program costs account for \$190 million of the total \$209 million net reduction in F.Y. 1996-97 expenditures. While changes in estimates are shown in the table for all other major programs, none of these are significant adjustments to the forecast. Typically, these changes reflect adjustments between categories, the impact of F.Y. 1996 closing and subsequent appropriation adjustments, transfers of funds between agencies, and changes in dedicated revenue estimates and related dedicated spending. These technical adjustments have no material impact on total estimated spending or the projected general fund balance.

Education Finance Spending Decreases \$1.8 Million

Total spending on education finance has changed little from end-of-session estimates, decreasing by \$1.8 million for F.Y. 1996-97. The decrease is the net result of an \$18.6 million increase in the general education program, offset by \$16.7 million in funds previously set aside for projected deficiencies in categorical aid programs, cancellation of \$2.0 million in the health and safety program and an additional \$1.7 million in miscellaneous negative adjustments. The primary reason for the increase in the general education program is an increase in the number of estimated pupil units.

Forecast reverses state aid payment shift

The budgetary balance forecast for F.Y. 1997 activates a provision in Minnesota Statutes 121.904, which increases spending by \$156.7 million (\$149.9 million in school aids payments and \$6.8 million in state paid aids and credits) in F.Y. 1997 by changing the state aid payment schedule for school districts. This action reverses a budget-balancing shift implemented in the mid-1980s. Currently, state payments to school districts are paid on an 85/15 basis. This means that in a given year, the funds that a district receives includes 85 percent of their entitlement for the current year, with the final 15 percent of their entitlement paid the next fiscal year. The final payment allows adjustments to the amount of state aid that a district receives based on final data on the number of pupils, etc. In 1985, the current year payment was adjusted downwards from 90 percent to 85 percent, providing the state with one-time savings. This one-time expenditure reverses that action.

Forecast provides “go-ahead” for \$180 million property tax recognition percent payment

While not a change from the end-of-session planning estimates, the November forecast permits reduction of the property tax recognition percent. A total of \$494.8

million will be spent in F.Y. 1996-97 to reduce the property tax “shift” from 37.4 to 7.0 percent. This one-time expenditure changes the mix of state aid and property tax proceeds that a district receives, but has no effect on the overall funding received by a district during a given fiscal year. As specified in Minnesota Statutes 16A.152, reduction of the shift was originally triggered by the surplus generated in the November, 1995 forecast. The F.Y. 1996 payment of \$314.8 million was certified to the Department of Children, Families and Learning in January, 1996, and distributed to school districts through the school aid metering system. Implementation of the F.Y. 1997 portion, totaling \$180 million, was contingent on funds being available in the current forecast. Payment of these funds to school districts will proceed immediately.

Forecast establishes “Education Aid Reserve” for F.Y. 1998-99

Laws 1996, Chapter 461 included a provision which is triggered by the projected F.Y. 1997 balance in the current forecast. This law sets aside a total of \$113.8 million in an “education aid reserve account” to be used for education programs by legislative appropriation in F.Y. 1998-99. While the amount of the reserve is determined by the amount needed to reduce the property tax recognition percent to zero, the funds in the reserve are not required to be used for shift reduction.

Post-Secondary Education Estimates Show \$36 Million Decrease

Larger Federal Student Aid awards contribute to \$8.5 million reduction in state Student Financial Aid program spending

The Higher Education Services Office forecasts a \$8.472 million (4.5%) decrease in State Grant Program expenditures for the F.Y. 1996-1997 biennium compared to the February 1996 forecast. Total State Grant awards of \$89.7 million are projected for F.Y. 1997, \$6.2 million (6.4%) less than the amount appropriated. Together with unspent State Grant appropriations of \$2.3 million carried forward from F.Y. 1996, projected cancellations at the close of the current biennium will be \$8.472 million.

The forecast reduction reflects declining enrollments at public colleges and universities and larger federal Pell Grant awards. Congress increased the maximum federal Pell Grant for F.Y. 1997 to \$2,470, \$130 above the amount presumed when appropriations for the State Grant budget were set.

Technical adjustment explains \$27 million reduction in MnSCU forecast

For several years Minnesota’s post-secondary systems have been allowed to carry forward all unspent revenues, but past methods of reflecting amounts carried forward in the state’s general fund forecast have proven confusing and misleading. Beginning with the November forecast, all of MnSCU’s unspent balances will be treated as dedicated appropriations. Previous forecasts had reported a portion of MnSCU’s balances as direct appropriations and assumed that this entire amount

was expended, in addition to the current law direct appropriation. Because MnSCU's budget does not segregate expenditures of direct appropriations from tuition and other dedicated revenue, this division of unspent balances was artificial.

The November forecast reports direct appropriated expenditures for MnSCU equal to the amount appropriated in law for the F.Y. 1996-97 biennium, minus \$1.6 million in intra-fund appropriation transfers to the Attorney General for contracted legal services. Amounts carried forward will be treated as a special budgeted reserve and included in the fund balance on a line labelled "appropriations carried forward".

Property Tax Aids and Credits Increase \$6.9 Million

The forecast of local aids and credits for the 1996-97 biennium is \$6.9 million above end-of-session estimates. The increase is largely due to higher than expected obligations in the property tax refund programs..

The regular homeowners refund has increased \$10.0 million and the regular renters refund \$2.9 million as a result of a substantial increase in the number of late filers from the previous year. The special property tax refund (targeting) estimate has also increased \$1.3 million because actual property tax increases in 1996 exceeded those previously forecast.

The lower estimate of Border City Disparity Credit is due to declines in the property value of commercial/industrial and apartment property in the border cities qualifying for the credit. As property value and the resulting property tax levied declines, less aid is required.

The forecast for Homestead and Agricultural Credit Aid (HACA) was essentially unchanged. However, these estimates will increase by \$6.0 million due to the one-time cost of changing aid to schools from an 85/15 basis to a 90/10 basis.

The current forecast for police and fire aid is \$4.6 million lower than end-of-session estimates. Required employer contributions to the Police and Fire Fund of the Public Employees Retirement Association (PERA) were lower than previously estimated, causing a reduction in the amount of police aid required to be paid. This reduction was partially offset by an increase in fire aid. The fire aid estimate is higher because additional revenue generated by 1996 changes to the fire aid allocation formula was higher than end-of-session estimates. In addition to these factors, \$2.1 million of the \$4.6 million decrease was due to a technical drafting error in 1996 legislation. The forecast includes \$2.1 million in resources to correct the error.

Total Human Services Forecast Decreases \$189 Million

The total forecast for the Department of Human Service entitlement programs for the current biennium has declined by \$189 million. This decrease is comprised of a

\$178 million decrease in health care program costs and a \$12 million decrease in other family support costs.

Health Care program costs reduced \$178 million

The forecast for health care spending is \$178 million lower than end-of-session estimates. This includes savings in Medical Assistance (MA) of \$134 million, General Assistance Medical Care (GAMC) of \$38 million, and Chemical Dependency Entitlements of \$6 million. Costs for medical services have not increased as rapidly as anticipated and delayed conversion to managed care contracts has shifted one-time costs into the next biennium.

In F.Y. 1996-97, state expenditures for MA are expected to be \$134 million less than projected at end of session. Long term care spending dropped due to lower estimates of the costs per resident day. Costs for waived services for the elderly and disabled are projected to change very little, with a slight increase in the number of recipients offset by a 5% decrease in service cost.

MA basic care costs are also below projected levels, due mostly to a delay in implementing managed care. Roughly \$10 million in one-time cash flow costs have been moved from the current biennium to the expenditure forecast for F.Y. 1998-99. Further expenditure reductions result from strong economic conditions, which reduced enrollment growth.

Included in the forecast is \$59 million cancelled from Medical Assistance (MA) and \$8 million from General Assistance Medical Care (GAMC). This money reflects F.Y. 1995 county obligations that were paid in F.Y. 1996.

GAMC is projected to cost \$306 million in the current biennium, or \$38 million less than previously forecasted. Approximately \$14 million of the savings is due to lower service costs. A higher cost case mix did not materialize, despite eligibility changes which removed the Work Readiness population from GAMC. Roughly \$16 million of the lower expenditure forecast is due to the delay in managed care, described above.

New federal laws had little effect on current health care spending. Reduced eligibility in several programs are expected to create future budget pressures, but added only an estimated \$3 million in state costs in the current biennium.

Declining unemployment reduced Family Support program estimates \$12 million

Estimated Family Support expenditures for the current biennium declined from estimates at the close of the 1996 legislative session. Expenditures are projected to drop by approximately \$11.9 million. The decrease is due primarily to the downward

revision of caseload estimates for Family Support programs in response to a strong state economy.

The largest decrease in estimated spending was in Aid to Families with Dependent Children (AFDC). The AFDC program's \$10.4 million decline followed larger than expected caseload declines in both years of the biennium. The remaining decline in estimated spending is attributed to decreases of \$2.6 million in Minnesota Supplemental Aid (MSA) and \$5.1 million in General Assistance (GA). These are offset by an increase of \$6.1 million in the Minnesota Family Investment Program (MFIP). A larger MFIP caseload is expected during F.Y. 1997 due in part to lower than expected attrition from the program.

The \$11.9 million decrease in estimated spending for the biennium would have been even larger, exceeding \$15.9 million, if not for the effects of two federal law changes. One of the changes eliminated the federal contribution to the state's pass-through of child support collections to public assistance recipients, costing the state \$2.8 million. The other change eliminated eligibility for the federal Supplemental Security Income program for drug addicts and alcoholics. This change decreased MSA obligations, but at the same time increased GA obligations. The net affect increased Family Support expenditures by \$1.2 million. With the exception of these items, federal changes, including federal welfare reform, will not affect Family Support spending during the current biennium.

Debt Service Estimates are \$8.0 Million Lower

The total estimated general fund debt service required for F.Y. 1996-97 is now \$471.2 million. Of the debt service total, \$27.1 million of cigarette taxes and a \$5.2 million portion of sales taxes related to sports and health clubs are directly deposited to the debt service fund by statute to meet existing debt obligations. The balance, \$438.9 million, represents the required transfer from the general fund to the debt service fund on outstanding and issued general obligation bonds and new bonds to be sold for authorized capital projects during the biennium.

The current spending estimate is \$8 million below end of session estimates. The savings result from the sale of fewer bonds in the May and November 1996 bond sales than the amount previously forecast. In addition, investment earnings on cash balances in the bond proceeds fund and the debt service fund were higher than forecast. Receipts from user financing also were higher than forecast. Partially offsetting these savings were higher interest rates on the bonds sold in May and November, 1996 than were forecast in February.

All Other Spending Shows Little Net Change

The forecast for all other spending remains largely unchanged. Total spending for state institutions, legislative, judicial and constitutional offices and state agencies,

operations, and miscellaneous grant programs is about \$ 5 million below previous estimates. Changes between individual categories do not reflect significant budget changes. Technical adjustments involving the treatment of non-CCA grant assistance in the Department of Corrections, state residential facility costs in the Department of Human Services, and the display of Department of Public Safety expenditures are highlighted by the comparison to the original appropriation amounts. Transfers of funds between specific agencies and the office of the Attorney General for legal services and other authorized transfers between agencies are also responsible for some differences from the original appropriations. These adjustments reflect F.Y. 1996 actual experience and normal year-to-date budget activity.

FOUR YEAR PLANNING HORIZON

F.Y. 1998-2001 Budget Planning Estimates

The November forecast contains two distinct sections of revenue and expenditure estimates for the next four years. These are distinguished primarily on the basis of shorter term forecasting (F.Y. 1998-99) and longer term planning estimates (F.Y. 2000-01).

F.Y. 1998-99 Budget Forecast

The revenue forecast is based on the November, 1996 DRI Control forecast. Expenditure estimates for F.Y. 1998-99 are based on current law and include spending limits enacted in 1995 for three of the fastest growing programs, education, human services and corrections. The expenditure planning estimates include discretionary inflationary of 3.0% per year in programs and administrative accounts.

1998-99 Biennial Budget Forecast (\$ in Millions)

	1996-97	1998-99	
Beginning Balance	\$1,021	\$1,319	
Revenues	19,099	20,485	+7.3%
Expenditures	<u>18,801</u>	<u>19,568</u>	+4.1%
Balance Before Reserves	1,319	2,235	
Cash Flow Account	350	350	
Dedicated Accounts	72	72	
School Aid Reserve	114	114	
Budget Reserve	<u>261</u>	<u>261</u>	
Ending Balance	\$522	\$1,439	

Forecast for F.Y. 1998-99 Improved From Prior Planning Estimates

At the end of the 1996 legislative session, planning estimates indicated a projected ending deficit of \$71 million for the F.Y. 1998-99 biennium.

The improved outlook for revenue growth in this forecast changes this outlook significantly. Increases over the planning estimates in the expected ending balance for the current biennium of \$698 million and a \$1,223 million increase in projected revenues are partially offset by an increase in projected spending of \$235 million, dedication of \$114 million to the School Aid Reserve account, and \$63 million in other changes. A comparison of the current forecast for F.Y. 1998-99 to the end of session planning estimate is presented as an appendix table on page 77.

It is important to note that the \$1.4 billion balance shown for F.Y. 1998-99 in the preceding table results from the \$522 million unallocated balance carried forward from the current biennium and the approximately \$450 million per year positive difference in forecast revenues and projected spending for the next biennium.

The impact of spending decisions by year and the use of a prior biennium's balance to support ongoing spending must be carefully considered by state policy makers to ensure that future expenditures can be supported by projected revenue growth.

F.Y. 2000-01 Budget Planning Estimates

Planning estimates of current law revenues and expenditures are presented for the F.Y. 2000-01 biennium as part of the November forecast. This is the first series of planning estimates for that period.

F.Y. 2000-01 revenue planning estimates are based on DRI long term projections for the 1999-2001 period. The planning estimates use the F.Y. 1998-99 forecast as a base. The estimates assume current laws and policies will continue unchanged. Expenditure estimates for F.Y. 2000-01 consider caseload, enrollment and other forecast variables in all major program areas and add the cost of potential discretionary inflation (3.0% per year) from the F.Y. 1999 forecast level of spending.

Unallocated balances shown for the current biennium and F.Y. 1998-99 remain unallocated and are assumed to carry forward. The estimates make no assumptions about the Governor's F.Y. 1998-99 proposed budget which will be presented in January, 1997.

F.Y. 2000-01 Long Term Planning Estimates (\$ in Millions)

	1998-99 Forecast	2000-01 Projection	
Beginning Balance	1,319	2,235	
Forecast Revenues	20,485	22,150	+8.1%
Estimated Expenditures	19,568	21,445	+9.6%
Balance (Before Reserves)	2,235	2,940	
Cash Flow Account	350	350	
Dedicated Accounts	72	72	
School Aid Reserve	114	114	
Budget Reserve	261	261	
Ending Balance	1,439	2,144	

These projections are not intended to predict a balanced or unbalanced budget in the future. Their purpose is to assist in determining how well the current expenditure structure matches expected future revenues based on trend projections of Minnesota's economy and what it will cost to maintain the same programs. The Governor and the Legislature will be required to make the necessary revenue and spending decisions to keep the state's budget balanced.

The impact of budget decisions on the F.Y. 2000-01 planning estimates will be displayed in the Governor's proposed budget and during the legislative session to show the fiscal impact of F.Y. 1998-99 budget decisions on the following biennium.

The Timing of Revenues and Expenditures Affects Structural Balance

Because the state constitution and statutes require that the budget balance state revenues and expenditures for a two year period, not for each year, the long term impact of increases in ongoing spending programs may not be readily apparent.

Hypothetical Budget Balancing Strategies

	<u>1998</u>	<u>1999</u>	<u>1998-99</u>	<u>2000</u>	<u>2001</u>	<u>2000-01</u>
<u>Example 1</u>						
Revenues	20,000	20,000	40,000	20,000	20,000	40,000
Spending	<u>20,000</u>	<u>20,000</u>	<u>40,000</u>	<u>20,000</u>	<u>20,000</u>	<u>40,000</u>
Balance	-0-	- 0 -	-0-	-0-	- 0 -	-0-
<u>Example 2</u>						
Revenues	20,000	20,000	40,000	20,000	20,000	40,000
Spending	<u>5,000</u>	<u>35,000</u>	<u>40,000</u>	<u>35,000</u>	<u>35,000</u>	<u>70,000</u>
Balance	15,000	(15,000)	-0-	(15,000)	(15,000)	(30,000)

The simple example shown above illustrates how, within a biennium, the same revenue forecast could support two widely different spending decisions and remain "balanced" for the first biennium. In the first example, revenues and expenditures are balanced in all four years of the planning horizon. In the second example, expenditures are "back-loaded" in the second year of the first biennium, leading to a structural imbalance in the second biennium. The result is dramatically different from the first example, and a large deficit occurs.

1998-99 Revenue Forecast

Total current resources are forecast to total \$20.485 billion in the 1998-99 biennium, up 7.3 percent from the level currently forecast for the 1996-97 biennium. This is the first official forecast of revenues for the 1998-99 biennium.

Net non dedicated revenues are expected to grow by 7.7 percent over the 1996-97 forecast, and the four major revenues, by an average of 8.5 percent. The income and the sales tax are expected to grow by 9.7 percent and 9.6 percent respectively, while the corporate income tax and the sales tax show growth of less than one percent.

F.Y. 1998-99 Revenue Forecast (\$ in Millions)

	<u>FY96-97 Biennium</u>	<u>FY 98</u>	<u>FY 99</u>	<u>FY98-99 Biennium</u>
Revenues				
Individual Income Tax	8,512	4,553	4,788	9,341
Sales Tax	5,930	3,172	3,329	6,501
Corporate Income Tax	1,377	677	708	1,385
Motor Vehicle Excise Tax	756	371	385	756
Four Major Taxes	16,575	8,773	9,210	17,983
Other Revenues	1,755	883	879	1,762
Net Non-dedicated Revenue	18,330	9,656	10,090	19,746
Other Resources	769	360	379	739
Current Resources	<u>19,099</u>	<u>10,016</u>	<u>10,468</u>	<u>20,485</u>

Previously reported revenue projections were only simple extrapolations of 1997 base level revenues. Current resources in this forecast exceeds the end of session planning estimate by \$1.223 billion. The method used to construct the planning estimates can lead to large differences between the planning estimates used for budget planning estimates and the actual forecast from which the budget is developed.

Large differences between the end of session revenue planning estimates and the first official forecast for a biennium are not unusual. Those difference come from three sources. First, any change in the base level from which the extrapolations are made, will be carried forward into the future. In the current forecast, stronger than anticipated growth in the U.S. economy in 1996 raised the base level of economic activity in 1997 and beyond, adding to revenues in 1998 and 1999. Second, differences between the economic growth rate used to extrapolate revenues in the

planning estimate and that used in the first forecast can magnify those differences in the starting point. For the 1998-99 biennium, forecast growth in some key elements of the economy, particularly consumer durable spending and capital equipment purchases, used in this forecast was well above that used in constructing February's planning estimates. Finally, growth rates in Minnesota may not track national economy. The planning estimates assume that Minnesota will grow at the rate of the national economy. While in recent years Minnesota has grown slightly faster than the U.S. average.

Individual Income Tax

Receipts from the individual income tax in the 1998-99 biennium are forecast to total more than \$9.341 billion, up more than \$829 million from levels expected for the 1996-97 biennium. DRI expects the strong national economic growth to continue through the end of the next biennium. Employment and wages are both projected to grow at healthy levels, leading to strong growth in the total amount of wages and salaries paid in Minnesota. Wage and salary disbursements are the single most important factor affecting individual income tax revenues.

Net capital gains are assumed to follow a normal pattern through the biennium, and net farm income has been increased to take account of the continuing effects of the 1996 farm bill on farm income. Changes in federal tax law, particularly changes affecting the treatment of income from capital gains would be likely to affect state revenues.

Sales Tax

Net sales tax receipts for the 1998-99 biennium are expected to be \$6.501 billion, 9.6 percent more than in the 1996-97 biennium. Gross sales tax receipts grow by more than 10 percent over the biennium, but the completion of the phase out of the sales tax on capital equipment causes sales tax refunds to grow even more rapidly. The two largest components of Minnesota's sales tax base, consumer durables and business capital equipment, are both projected to grow at more than a 5 percent rate in fiscal 1998. In fiscal 1999, capital equipment spending continues to grow at more than a 5 percent rate while the growth rate in consumer durable spending slows to 4 percent. These growth rates are well above those used for the planning estimates for 1998-99 revenues.

Corporate Income Tax

Corporate income taxes are estimated to total \$1.385 billion in the 1998-99 biennium, up 0.6 percent from levels expected for the 1996-97 biennium. The DRI Control forecast of before tax corporate profits shows little growth in national corporate profits during 1997 and 1998, following the relatively rapid run-up observed during the current year. DRI believes that global competition will force

producers to absorb some of the input pricing pressures and wage demands likely to occur. Absorbing these higher costs will limit the opportunity for profit growth.

Motor Vehicle Excise Tax

Motor vehicle excise tax receipts for the 1998-99 biennium are forecast at \$756 million, unchanged from current levels. Receipts actually fall from F.Y. 1996 levels in F.Y. 1997, and again in F.Y. 1998, before recovering to a new high in F.Y. 1999. DRI's Control forecast shows almost no growth in light vehicle sales over the forecast horizon.

Other Revenues

Little change is expected in other revenues during the 1998-99 biennium. Other tax revenues grow by just under two percent, while other non tax revenues fall by 10 percent. Other dedicated revenues and transfers show slight gains. Other revenues and other resources are expected to total \$2.487 billion in the 1998-99 biennium.

2000-01 Revenue Planning Estimates

Current resources for the 2000-01 biennium are projected to reach \$22.150 billion, 8.1 percent above the 1998-99 forecast. The four major taxes are expected to grow by 9.0 percent, while other tax and non tax revenues grow by 1.6 percent.

This baseline planning estimate is not an explicit forecast. It is simply an extrapolation of projected trends in the economy. Because of the way it is constructed, any changes in the base level of revenues in fiscal 1997, 1998, or 1999 will be reflected in the planning estimates for 2000 and 2001. Other things equal, stronger than anticipated growth in any one of those years will add significantly to revenues available in the 2000-01 biennium. Similarly, should the economy grow more slowly during any of the next three years than forecast, the revenue outlook for 2000-01 will deteriorate.

The revenue planning estimates are only a guide to the level of future revenues, not a guarantee. If the economy remains strong through 1999, the planning estimates are likely to underestimate future revenues. But, if the economy fails to perform at the high level anticipated in the November DRI control, the planning estimates will overstate future revenues.

F.Y. 2000-01 Revenue Planning Estimates (\$ in Millions)

	FY98-99 Biennium	FY00	FY 01	FY2000-01 Biennium
Revenues				
Individual Income Tax	9,341	4,991	5,204	10,195
Sales Tax	6,501	3,468	3,609	7,077
Corporate Income Tax	1,385	739	778	1,517
Motor Vehicle Excise Tax	756	401	418	820
Four Major Taxes	17,983	9,599	10,009	19,608
Other Revenues	1,762	889	901	1,790
Net Non-dedicated Revenue	19,745	10,488	10,910	21,398
Other Resources	739	359	394	752
Current Resources	<u>20,484</u>	<u>10,847</u>	<u>11,304</u>	<u>22,150</u>

The projected growth rate for F.Y. 2000-01 revenues exceeds that forecast for the 1998-99 biennium. Revenue growth rates in the 1998-99 biennium were unusually low because of several one time events which affected tax liabilities in 1997. When compared to growth rates in previous biennia, revenue growth in 2001-2002 is

slightly slower than average.

Estimates of 2000-01 revenues are based on DRI's Summer, 1996 Cycle and November Control forecasts. Nominal growth rates for key variables used in projecting tax revenues are computed by multiplying the appropriate inflation estimate for the year in question from the Control forecast by the average real growth rate for the series computed over the entire 25 year Cycle forecast horizon.

In October, 1996 DRI extended the forecast horizon for its Control forecast to 5 years. Because there is no history on the reliability of the four and five year Control forecast, the Department of Finance has chosen to continue using its current methodology for preparing revenue planning estimates. Department economists will evaluate the DRI Control's year four and year five projections throughout the coming biennium and decide in conjunction with the Council of Economic Advisors whether the base for future long term planning estimates should be changed in November, 1998.

Individual income tax estimates were prepared using the House Income Tax Simulation Model. Assumed filer growth in Minnesota was consistent with average national employment growth in the Cycle forecast. All elements of taxable income and all individual itemized deductions were assumed to grow at the rate forecast by DRI for taxable personal income. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 1999.

Future sales tax revenues were estimated by computing percentage growth rates for each of seven broad categories of products in the sales tax base. Those growth rates, based on real growth from DRI's Summer, 1996 Cycle forecast and inflation from the November Control forecast, were then weighted by the fraction of the expected 1999 sales tax base attributable to each category of purchases. The sum of the weighted growth rates was used as a measure of expected growth in the sales tax base for 2000 and 2001.

Corporate tax receipts in Minnesota were estimated to grow at the same rate as the DRI's forecast of national before tax corporate profits. Minnesota's motor vehicle excise tax collections are expected to grow at the same rate as the national consumption of motor vehicles and parts. Planning estimates for other tax and non tax revenues were prepared by extrapolating existing trends.

It is impossible to anticipate the economy's performance four or five years in advance. Economic projections that far into the future can only be extrapolations of historical trends consistent with the current short term outlook.. It is important to remember that the long term revenue planning estimate is only a guide to what revenues four and five years from now might be, not a guarantee of a specific level of revenues, and that there can be large positive or negative errors in that long term estimate.

1998 - 2001 Expenditure Estimates

F.Y. 1998-99 Budget Planning

Under current law, expenditure planning estimates for F.Y. 1998-99 total \$19.568 billion, a 4.1 percent increase over the current forecast for 1996-97 spending. As a point of comparison, however, F.Y. 1996-97 contains two significant one time expenditures for school property tax recognition adjustments and payment changes.

These one time expenditures total \$651.5 million. If these are factored out of F.Y. 1996-97 totals, the F.Y. 1998-99 forecast of ongoing expenditures would represent a 7.8 percent increase over the current biennium.

In the 1995 session, the legislature enacted spending limits for F.Y. 1998-99 for three of the largest or fastest growing spending areas: Education Finance, the Department of Human Services, and the Department of Corrections. These enacted spending limits were based on the projected 1998-99 cost of the Governor's proposed budget for F.Y. 1996-97, which recognized expected caseload or enrollment growth and inflation. The limits enacted in law define the upper limit for spending within the forecast for F.Y. 1998-99 for these areas.

1998-99 Projected Spending (\$ in Millions)

	F.Y. 1996-97	F.Y. 1998-99		
Major Programs	Biennium	Forecast	\$ Chg.	% Chg.
Education Finance	\$5,892.0	\$5,939.1	47.1	0.8%
Property Tax Recognition	494.8	0.0	(494.8)	--
School Payment Change	156.7	0.0	(156.7)	--
Post-Secondary Education	2,148.7	2,170.3	21.6	1.0%
Local Aids & Credits	2,411.9	2,451.0	39.1	1.6%
Other Major Local Assist.	861.2	1,016.6	155.4	18.1%
Health Care	2,976.3	3,856.1	879.8	29.6%
Family Support	488.9	559.4	70.5	14.4%
State Operated Institutions	826.5	900.4	73.9	8.9%
Legis. Judicial, Const. Offcs	476.3	480.2	3.9	0.8%
State Agencies	1,422.4	1,428.8	6.4	0.5%
Debt Service and Other	438.9	545.9	107.0	24.4%
Estimated Cancellations	(15.0)	(20.0)	(5.0)	33.3%
Subtotal	18,580.0	19,327.8	748.2	4.0%
Dedicated Expenditures	221.1	240.5	19.4	8.8%
Total Spending	\$18,800.7	19,568.3	767.6	4.1%

Potential changes in expected inflation do not affect the limits. In some cases, however, the laws provide that adjustments may be made to the limits for caseload, enrollment, or specified changes in forecast factors.

For budget planning purposes, a 3.0 percent per year cost increase in goods, services and minor state grant programs is included in the 1998-99 estimates. This *discretionary* inflation is not required by current law, but reflects the impact of expected price increases on the cost of government operations. Discretionary inflation for programs accounts for \$440 million of the \$768 million growth.

F.Y. 2000-01 Expenditure Estimates

A two year projection is presented for expenditures beyond the F.Y. 1998-99 biennial budget which will be presented and adopted in the 1997 session. These outyear estimates serve as a guide to the affordability of longer term policy choices.

2000-01 Spending Planning Estimates (\$ in Millions)

	F.Y. 1998-99	F.Y. 2000-01		
Major Programs	Forecast	Plng. Estimate	\$ Chg.	% Chg.
Education Finance	\$5,939.1	6,323.8	384.7	6.5%
Post-Secondary Education	2,170.3	2,311.7	141.4	6.5%
Local Aids & Credits	2,451.0	2,466.9	15.9	0.7%
Other Major Local Assist.	1,016.6	1,106.9	90.3	8.9%
Health Care	3,856.1	4,795.0	938.9	24.3%
Family Support	559.4	620.8	61.3	11.0%
State Operated Institutions	900.4	991.6	91.2	10.1%
Legis. Judicial, Const. Offcs	480.2	509.2	29.0	6.0%
State Agencies	1,428.8	1,516.6	87.8	6.1%
Debt Service and Other	545.9	582.4	36.5	6.7%
Estimated Cancellations	(20.0)	(20.0)	0.0	--
Subtotal	19,327.8	21,204.9	1,877.1	9.7%
Dedicated Expenditures	240.5	240.5	0.0	--
Total Spending	\$19,568.3	21,445.4	1,877.1	9.6%

All F.Y. 2000-01 expenditure projections begin with the forecast level of spending for F.Y. 1997. In the case of education finance, which was subject to legislated spending limits for F.Y. 1998-99, the projections assume the limits remain as

enacted for F.Y. 1998-99, and that F.Y. 1999 spending as shown under the limits becomes a revised base for future projections.

Major state programs are projected based on forecast caseload and enrollment growth, changes in federal mandates and participation, existing statutory requirements or formulae. All state programs and agencies' growth generally only reflects the potential cost of discretionary inflation of 3.0 percent per year during F.Y. 2000-2001.

F.Y. 1998-99 Education Aids Increase \$47 million

Estimated spending for education aids programs, excluding agency spending, will total \$5.94 billion in F.Y. 1998-99. This is an increase of \$47 million over F.Y. 1996-97, after adjusting for one-time spending related to the property tax recognition percent and the 90/10 state aid adjustment.

These figures have changed minimally since end-of-session estimates, with decreases of \$0.5 million in the general education program, and \$0.5 million in categorical programs. While the estimated number of pupils has increased, other changes, including the effect of moving state aid payments from an 85/15 basis to a 90/10 basis, offset the increase associated with higher pupil estimates.

Spending limits, or appropriation "caps," were established for education finance programs in the 1995 session. The legislation establishing the limits provided that they be adjusted for changes in pupil unit forecasts, levies or other factors generating entitlements for the general education program. Due to the minimal changes in this forecast for F.Y. 1998-99, the limits will remain at their end-of-session levels of \$2.981 billion in F.Y. 1998 and \$3.041 billion in F.Y. 1999.

The spending limits reduce anticipated expenditure growth by a total of \$270 million over the biennium. This figure is the net effect of \$337 million in reductions due to a \$75 decrease in the general education formula in F.Y. 1998, reductions in the secondary pupil weight in both F.Y. 1998 and F.Y. 1999, and an offset of \$67 million of unallocated funds. Without the limits in law, planning estimates for K-12 education would also include \$330.3 million in potential discretionary inflation.

The \$47 million increase in education spending is the net effect of a lengthy list of changes which serve to offset the downward effects of the appropriation limits (\$270 million). The largest of these include:

- (1) an increase of \$169 million due to growth in the number of pupils;
- (2) an increase of \$28 million due to referendum;
- (3) an increase of \$126 million from continued roll-in of school HACA into the special education formula;
- (4) an increase of \$6 million from continued phase-in of transition aid related to changes in the transportation and training and experience formulas; and
- (5) a decrease of \$12 million from miscellaneous negative adjustments.

Education Aids Grow by \$384 million in F.Y. 2000-01

Under current law, with the F.Y. 1998-99 appropriation limits in place, planning estimates for F.Y. 2000-01 for K-12 programs grow by \$383.6 million over F.Y. 1998-99. Apart from the \$214 million cost of discretionary inflation, the primary change is a \$100 million increase associated with the continued phase-in of school HACA into the special education formula.

Planning estimates for F.Y. 2000-01 are again affected by the appropriation limits in law for F.Y. 1998-99. F.Y. 2000-01 savings associated with the formula reduction and the weighting change total \$407 million, partially offset by the \$99.3 million unallocated fund pool. The compounded effect of inflation on the uncapped base over the F.Y. 1998-2001 period totals \$709 million.

While Laws 1992, chapter 499 repealed all Minnesota Statutes relating to school finance, effective June 30, 1999, for the purposes of planning estimates, continuation of existing law has been assumed.

Post-Secondary Education Spending Increases \$21.6 million

Post-secondary education expenditures for the F.Y. 1998-1999 biennium are forecast to increase by \$21.6 million (1.0%) above spending in the current biennium. Deductions of non-recurring appropriations to the University of Minnesota and Minnesota State Colleges and Universities (MnSCU) lower base-level expenditures before inflation by \$80.5 million (-3.7%). Net forecast adjustments for enrollment increases at the University of Minnesota and declining enrollment at MnSCU increase biennial expenditures by \$4.1 million. Inflation adjustments of \$94.5 million, together with an open and standing appropriation of \$3.6 million to MnSCU for interest earnings, bring post-secondary education expenditures for the 1998-1999 biennium to \$2.17 billion.

Post-Secondary Planning Estimates for F.Y. 2000-01 Increase \$141 million over F.Y. 1998-99

F.Y. 2000-01 planning estimates for post-secondary education reflect a \$133 million increase from the impact of expected discretionary inflation over F.Y. 1998-99 amounts, and an \$8 million increase from annualization of enrollment increases between F.Y. 1998 and F.Y. 1999.

Property Tax Aids and Credits Will Increase \$39 Million for F.Y. 1998-99

Property tax aids, credits and local government aids in the 1998-99 biennium are expected to increase \$39.1 million over the 1996-97 biennium. Expenditures vary from 1996-97 amounts due to various factors, including changes in formulas and economic factors, the conversion of some local aids to other types of local aid, and the restoration of one-time cuts in local aid.

The Regular Homeowner's Refund will be \$28.4 million higher and the Regular Renter's Credit \$5.8 million higher due to the indexing of income categories for inflation and projected growth of property taxes. Special Property Tax Refund (Targeting) estimates are \$2.3 million lower than F.Y. 1996-97 estimates due to flattening estimates of yearly property tax growth. Also included is a F.Y. 1999 appropriation for aid to counties to administer the placement of the property tax refund on the property tax statement, effective calendar year 1998.

Local Government Aid (LGA) increases by \$40.1 million as a result of being indexed to a state and local government cost index. Homestead and Agricultural Credit Aid (HACA) decreases by \$100 million due to the conversion of HACA to County Criminal Justice Aid, the continuing conversion of school HACA payments to aid for special education, and the conversion of HACA to Local Performance Aid, and the one time nature of the change in school district payments to 90/10. The decreases are offset by household and pupil growth adjustments, the reinstatement of a one-time F.Y. 1997 cut of \$16 million, and additional aid to compensate local governments for reductions in the property classification rate of seasonal/recreational property, enacted in the 1996 legislative session. County Criminal Justice Aid increases \$25.9 million due to indexing, as well as the conversion of some HACA to County Criminal Justice Aid. Added to the F.Y. 1998-99 biennium is a new form of local assistance, Local Performance Aid, funded by conversion of HACA and an additional appropriation.

Aid to Police and Fire grows \$19.5 million over the FY96-97 biennium due to continued growth in employer contributions to the Police and Fire Fund of the Public Employees Retirement Association (PERA).

Local Aids and Credits Will Grow in F.Y. 2000-01 Under Current Law Indexing

F.Y. 2000-01 planning estimates for local aids and credits reflect a \$56.7 million increase over F.Y. 1998-99 estimates. Regular Homeowner's Refunds increase by \$38.5 million and Regular Renter's Refunds increase by \$14.4 million due to the indexing of income categories as well as underlying economic factors. The Special Property Tax Refund (Targeting) increases \$1.7 million due to continuing property tax increases. Local Government Aid (LGA) increases by \$33.6 million and County Criminal Justice Aid increases by \$2.5 million due to being indexed to a state and local government price deflator. Homestead and Agricultural Credit Aid decreases by \$97.2 million due to the continuing conversion of the school portion to special education aids, offset somewhat by household growth in HACA payments to non-school local governments. Local Performance Aid grows \$1.8 million due to inflation adjustment. Aid to Police and Fire increases by \$17.0 million due to projected increases in employer contribution to PERA funds.

Other Major Local Assistance Programs Grow by \$155 million for F.Y. 1998-99

Other state grants to local units of government and nonprofit organizations are forecast to grow by \$155.5 million for F.Y. 1998-99.

Various Human Services grants account for almost \$93 million of the increase between F.Y. 1996-97 and F.Y. 1998-99. Over \$46 million of the Human Services grant total is due to new Group Residential Housing expenditures from anticipated enrollment increases and federal changes in Supplemental Security Income (SSI) eligibility. Drug and alcohol addicted persons will no longer receive federal SSI payments, which in turn will increase the costs of the Group Residential Housing program. The remaining growth in Human Services grants is distributed across a number of programs.

The Ethanol Development subsidy will increase \$24 million based on estimated payments to producers.

Technical presentation of the transfer of the non-entitlement Sliding Fee Child Care program from the Department of Human Services to the Department of Children, Families, and Learning for F.Y. 1997 explains \$31 million of the apparent increase between bienniums in other major local assistance.

The remaining growth in this spending category is distributed among several smaller state grant programs.

Discretionary inflation accounts for almost \$35 million of the \$155.5 million total growth between the 1996-97 and 1998-99 bienniums in other major local assistance.

F.Y. 2000-01 planning estimates project an additional \$90 million growth in other major local assistance spending over F.Y. 1998-99. Potential discretionary inflation increases, additional growth of \$29 million (after inflation) in the DHS Group Residential Housing program, and decreases of \$26 million in other grant programs base spending account for the net growth.

Health Care Spending for F.Y. 1998-99 Will Increase \$880 Million; an Additional \$939 Million in F.Y. 2000-01

In F.Y. 1998-99, state health care costs are expected to grow by \$880 million over the F.Y. 1996-97 level of \$2.98 billion. This growth includes an \$810 million increase in Medical Assistance (MA), \$73 million increase in General Assistance Medical Care (GAMC), and \$3 million decrease in Chemical Dependency Entitlements. Expenditure growth is following a path set in prior forecasts, driven by increased enrollment and service costs. Modest expenditure savings in the November forecast are more than offset by new costs associated with federal law changes and expenditures shifted from the previous biennium. Spending estimates include \$115 million for discretionary inflation.

Forecasted Medical Assistance expenditures in F.Y. 1998-99 are \$810 million more than the F.Y. 1996-97 level \$2.6 billion. After closing adjustments, increased caseloads, and increases resulting from more expensive case mix, MA spending changes as follows:

- \$242 million for basic health care for the aged and disabled;
- \$114 million for waived programs and home care spending;
- \$196 million for basic health care for families and AFDC recipients;
- \$39 million for long term care facilities.
- \$150 million in estimated discretionary inflation.

A change in the federal matching rate drives up forecasted F.Y. 1998-99 expenditures in each MA segment, costing the state nearly \$100 million. By law, the federal government shares in the cost of Medical Assistance, with reimbursement based upon Minnesota's per capita income relative to other states. The new matching rate drops the federal share of expenditures from 53.6% of the total to 52.14%. This decline is the second largest drop in the nation, topped only by Michigan's loss.

In F.Y. 1998-99, \$34 million in new costs are forecast for care of persons eliminated from federal programs. Proposals signed into law this fall eliminated Supplemental Security Income (SSI) eligibility for drug and alcohol addicted persons. Welfare reform proposals also limited federal assistance to legal immigrants. Under current state law, many of these individuals will qualify for Minnesota programs.

Spending in F.Y. 1998-99 is increased in both MA and GAMC due to delays in converting state programs from fee for service to managed care. The slower implementation schedule has allowed for greater county and local input but it also pushes one-time cash flow costs into future years. When added to lost price discounts, the delay adds \$43 million to MA and \$19 million in GAMC spending for the F.Y. 1998-99 biennium.

F.Y. 1998-99 GAMC expenditures are projected to grow by \$73 million over the F.Y. 1996-97 level of \$306 million. This growth is consistent with previous forecasts and includes an estimated \$17 million in discretionary inflation. Costs caused by federal law changes were largely offset by reductions in the anticipated cost per recipient.

Health care spending in F.Y. 2000-01 is forecast to grow by \$939 million over the F.Y. 1998-99 level of \$3.856 billion. This includes estimated growth in Medical Assistance (MA) of \$859 million, General Assistance Medical Care (GAMC) of \$58 million, and Chemical Dependency Entitlements of \$22 million. Projected costs include \$474 million in discretionary inflation for F.Y. 2000-01.

All segments of the Medical Assistance program increase due to demographic and case mix pressures. Even before discretionary inflation, the forecast includes the following:

- \$50 million increase in long term care facilities;
- \$153 million increase in waived services and home care;
- \$239 million increase in basic care for the aged and disabled;

- \$145 million increase in basic care for AFDC and other families.

F.Y. 1998-99 Family Support Programs Increase \$71 Million; an Additional \$61 Million for F.Y. 2000/2001

On August 22, 1996, the federal congress enacted major federal welfare reform. Aid to Families with Dependent Children (AFDC), an open-ended federal entitlement program, was eliminated and replaced with a Temporary Assistance for Needy Families (TANF) block grant. This legislation also made extensive changes to child care, food stamp, and child support enforcement programs. AFDC spending is the largest component of the state's Family Support spending. The state must adopt a TANF plan by July 1, 1997, the first day of F.Y. 1998.

The state may spend the TANF block grant funds for the same purposes as AFDC funds, but federal funding is limited to a fixed block grant amount of \$268 million. Each dollar of state spending will not automatically result in a corresponding increase in federal contributions to the state as was the case under AFDC. As a result, the state bears additional financial risk associated with unexpected increases in state entitlement spending in the future.

Expenditures for F.Y. 1998-99 biennium were forecasted assuming continuation of current state family support policies because of the difficulty of predicting the specific, TANF related decisions that will be made by the Governor and the legislature during the 1997 legislative session. Projecting state spending into the future assuming continuation of current policy provides a useful starting point for required decision-making during the upcoming legislative session. Total federal revenues under the TANF block grant for the F.Y. 1998-99 biennium are not expected to vary significantly from estimates of federal revenues that would have been received under AFDC. This suggests that the projected biennial expenditures in this forecast could be supported under the new funding mechanism.

Current law forecast for F.Y. 1998-99 yields a Family Support planning estimate increase of \$ 71 million from F.Y. 1996-97. Much of the increase is a result of caseload growth returning to its upward trend in response to slight increases in both unemployment and the number of out-of-wedlock births. AFDC caseload reductions resulting from the availability of the MinnesotaCare program have also declined from the previous biennium due to slower overall growth in MinnesotaCare enrollment. The largest increase in estimated spending is in AFDC. It grew by \$38 million, \$12.8 million of which was inflation. The remaining increase in the planning estimates may be attributed to spending growth of \$9.7 million in Minnesota Supplemental Aid (MSA) and \$32.3 million in General Assistance (GA). Discretionary inflation constituted \$2.4 million of the growth in MSA and \$5.6 million of the growth in GA. The majority of the increase in GA was generated by eligibility changes in the federal Supplemental Security Income program.

The increases in AFDC, GA, and MSA were offset by a \$9 million decrease from categorization changes related to transfers of childcare monies to CFL.

Family Support spending in F.Y. 2000-01 is forecasted to grow by \$61 million over the F.Y. 1998-99 level of \$517.6 million. This includes estimated growth in Aid to Families with Dependent Children (AFDC) of \$64.5 million, General Assistance (GA) of \$22.4 million, Minnesota Supplemental Aid of \$16.5 million, and Child Care entitlements of \$3.5 million. These are offset by savings of \$45.6 million from expiration of the Minnesota Family Investment Program field trials. Discretionary inflation accounts for \$34.1 million of spending growth during the biennium. Most of the remaining increase is due to forecasted caseload increases.

Correctional Institution Program Costs Drive Increases for State Institutions

The cost of operating state institutions (residential treatment centers, prisons, Faribault Academies, the Arts School and veteran's homes) is expected to increase \$73.8 million in F.Y. 1998-99. Discretionary inflation accounts for \$38 million of this amount.

Operating the state's expanding prison system to accommodate growing numbers of inmates is the major factor in the growth in state institutions' spending. The F.Y. 1998-99 forecast cost of state correctional facilities is expected to grow by \$43 million over the current biennium. In addition to potential discretionary inflation of \$18 million, the F.Y. 1998-99 estimates include a \$9 million *reduction* in current base operating costs, \$23 million for additional state prison space coming on line after the start of F.Y. 1997, and \$11 million for rental of non state-owned facilities to house inmates.

State residential facilities operated by the Department of Human Services are the second largest source of growth for state institutions. State residential facilities are forecast to grow by \$27 million in F.Y. 1998-99, virtually all of which is caused by inflation.

F.Y. 2000-01 planning estimates for state institutions show net growth of \$91.2 million. The projected \$28 million cost of new prison bed space at the Rush City and Brainerd facilities represents the only programatic growth.

Legislature, Judicial, Constitutional Offices

Spending for legislative, judicial and constitutional officers increases by \$3.9 million in F.Y. 1998-99. However, this amount includes \$20.5 million in discretionary inflation, so this represents real decline in base spending of \$16.6 million compared to F.Y. 1996-97. About of this decline is explained by a technical factor in how the budget for the Attorney General is presented; funds for "partner agency" agreements for legal services will be appropriated in those agencies for transfer to the AG's office. The remaining difference is distributed among the other agencies in this budget area.

Planning estimates for F.Y. 2000-01 reflect only the expected impact of continued discretionary inflation, accounting for the \$29 million increase shown over F.Y. 1998-99 forecast levels.

State Agencies

State agencies' operations and grants show total net growth of \$6.4 million over the current biennium. Base reductions in one-time spending and transfers between agencies and spending categories offset an estimated \$61 million cost of discretionary inflation for state agencies in F.Y. 1998-99.

Planning estimates for F.Y. 2000-01 largely reflect only the expected impact of continued discretionary inflation, accounting for the \$87.8 million increase shown over F.Y. 1998-99 forecast levels.

Debt Service Costs Reflect Planned Future Sales

Debt Service for the 1998-99 biennium remains unchanged from the February 1996 planning estimates. The total general fund amount needed for the next biennium is \$564.5 million. This amount includes \$14.1 million from the cigarette tax and \$4.8 from the sports and health club tax leaving a net amount needed from the general fund of \$545.6 million.

The \$564.5 million is the amount needed during the 1998-99 biennium to meet the constitutional requirements for the debt service transfer from the general fund to the debt service fund on outstanding general obligation bonds, additional bond sales for currently authorized projects, and to fund the planned capital budget of \$500 million in the 1998 session.

The F.Y. 1998-99 estimate is based on three tax exempt general obligation bond sales totaling \$562 million for currently authorized capital projects during the biennium and three taxable bond sales totaling \$18 million for the Rural Finance Authority(RFA) programs.

1998-99 Planned Bond Sales (for currently authorized bonds)

(\$ in millions)

Date	Amount	Interest Rate
August 1997	\$180	4.8%
April 1998	\$180	5.0%
August 1998	\$202	5.1%

These interest rates are all higher than the interest rates forecast in February, 1996 and are based upon the DRI November, 1996 interest rate forecast for tax exempt bonds.

The size of each bond sale is based upon cash flow estimates for existing authorizations as of October, 1996. Additional bonds would be sold to provide financing for new capital projects approved by the 1998 Legislature.

The three RFA taxable bond sales are sold at the same time as the tax exempt sales at interest rates of 6.65%, 6.80% and 6.65%. Each sale would total \$6 million.

The debt service planning estimates for the F.Y. 2000-01 biennium are a continuation of the current debt service plan. Bonds would be sold for \$71 million of existing authorizations and additional bonds would be sold for new authorization approved during the 1998, 1999 and 2000 legislative sessions. Interest rates on the bonds sold during this biennium are forecast to be higher than were forecast in February, 1996. The planning estimates assume new bonding authorizations of \$30 million in 1999 and \$500 million in 2000.

ALTERNATIVE FORECAST COMPARISON

Real GDP (Annual Rates)

	<u>96II</u>	<u>96III</u>	<u>96IV</u>	<u>97I</u>	<u>97II</u>	<u>97III</u>	<u>97IV</u>	<u>95A</u>	<u>96A</u>	<u>97A</u>	<u>98A</u>
DRI Control1196 \$92 C.W.	4.7	2.2	2.3	1.8	1.4	2.5	2.6	2.0	2.4	2.4	2.4
Goldman-Sachs (10-96)	4.7	2.1	3.8	3.1	2.8	2.2	2.0	2.0	2.4	3.0	1.3
Blue Chip (11-96)	4.7	2.2	2.2	2.2	2.0	1.9	2.0	2.0	2.4	2.2	n.a.
American Express (IDS) (11-96)	4.7	2.2	2.3	2.1	1.9	2.4	2.3	3.5*	1.3*	2.8*	2.3*
Merrill-Lynch (11-96)	4.7	2.2	1.6	1.7	1.8	2.2	2.2	2.0	2.3	2.0	n.a.
CS First Boston (11-96)	4.7	2.2	2.2	2.4	2.8	1.8	1.1	2.0	2.3	2.4	n.a.

* 4Q/4Q

GDP Deflator (Chain-Weighted, Annual Rates)

	<u>96II</u>	<u>96III</u>	<u>96IV</u>	<u>97I</u>	<u>97II</u>	<u>97III</u>	<u>97IV</u>	<u>95A</u>	<u>96A</u>	<u>97A</u>	<u>98A</u>
DRI Control1196 \$92 C.W.	2.2	1.9	2.3	3.0	2.3	1.9	2.0	2.5	2.1	2.4	2.3
Goldman-Sachs (10-96)	2.2	2.0	2.3	2.5	2.8	3.1	3.4	2.5	2.1	3.0	3.5
Blue Chip (11-96)	2.2	1.9	2.3	2.5	2.5	2.5	2.6	2.5	2.1	2.4	n.a.
American Express (IDS) (11-96)	2.2	1.8	2.1	2.7	2.6	2.8	2.9	2.5*	2.1*	2.7*	n.a.
Merrill-Lynch (11-96)	2.2	1.9	1.5	2.2	2.5	2.2	2.2	2.5	2.0	2.1	n.a.
CS First Boston (11-96)	2.2	1.9	3.0	3.0	2.7	2.0	2.1	2.5	2.1	2.5	n.a.

* 4Q/4Q

FORECAST COMPARISONS

Real Economic Growth (Annual Percent Change in Real GDP)

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Nov 92 DRI Control	2.8	2.7				
Feb 93 DRI Control	2.4	2.5				
Nov 93 DRI Control	2.1	3.1				
Feb 94 DRI Control	2.1	3.3				
Nov 94 DRI Control	2.1	3.0	1.8 ⁽¹⁾	1.8 ⁽¹⁾	1.8 ⁽¹⁾	1.8 ⁽¹⁾
Feb 95 DRI Control	1.7	3.0	1.7 ⁽¹⁾	1.7 ⁽¹⁾	1.7 ⁽¹⁾	1.7 ⁽¹⁾
Nov 95 DRI Control	2.1	2.8	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾
Feb 96 DRI Control	2.1	2.8	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾	1.7 ⁽²⁾
Nov 96 DRI Control	2.4	2.4	2.4	2.0	1.6 ⁽³⁾	1.6 ⁽³⁾

Inflation

(Annual Percent Change in Implicit GDP Deflator - 1992 = 100)

Nov 92 DRI Control	2.6	2.6				
Feb 93 DRI Control	2.4	2.5				
Nov 93 DRI Control	2.7	2.4				
Feb 94 DRI Control	2.6	2.4				
Nov 94 DRI Control	2.7	2.8	3.7 ⁽³⁾	3.7 ⁽³⁾	3.7 ⁽³⁾	3.7 ⁽³⁾
Feb 95 DRI Control	2.4	2.3	3.2 ⁽³⁾	3.2 ⁽³⁾	3.2 ⁽³⁾	3.2 ⁽³⁾
Nov 95 DRI Control	2.0	1.9	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾
Feb 96 DRI Control	1.9	1.7	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾	2.1 ⁽⁴⁾	2.4 ⁽⁴⁾
Nov 96 DRI Control	2.1	2.4	2.3	2.4	2.6	2.8

(1) Long-term trend from DRI Cyclelong, Summer 1994 and Winter 1994/95.

(2) Long-term trend from DRI Cyclelong, Summer 1995.

(3) Long-term trend from DRI Cyclelong, Summer 1996.

(4) Summer 1994 and Winter 1994/95 DRI Trendlong Forecast.

(5) November 1995 Trendlong.

(6) November 1996 Trendlong.

MINNESOTA - U.S. COMPARISON REPORT

Annual Percent Changes

February 1996 Control

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Wage and Salary Income								
United States	5.6	3.5	4.9	5.8	5.9	5.4	4.5	4.2
Minnesota	7.9	4.2	6.4	6.8	6.3	5.2	4.6	4.7
Implied Annual Wage								
United States	5.3	1.5	1.8	3.1	3.8	3.8	3.0	2.7
Minnesota	5.5	1.6	3.2	3.9	4.1	3.5	3.2	3.3
Non-Farm Employment								
United States	0.3	1.9	3.1	2.7	2.0	1.6	1.4	1.5
Minnesota	2.3	2.6	3.0	2.8	2.1	1.7	1.4	1.4
Personal Income								
United States	6.0	4.1	5.0	6.3	5.5	5.1	4.8	4.6
Minnesota	7.2	3.4	7.4	6.0	6.2	4.6	4.8	4.9

Comparison of Actual and Estimated Non-Restricted Revenues Fiscal Year-To-Date, Through October, 1996

(\$ in thousands)

	<u>Forecast Revenues</u>	<u>Actual Revenues</u>	<u>Variance Act-Fcst</u>
Individual Income Tax			
Withholding	1,137,600	1,211,019	73,419
Declarations	144,100	166,770	22,670
Miscellaneous	44,400	49,326	4,926
Gross	1,326,100	1,427,115	101,015
Refunds	22,709	21,983	(726)
Net	1,303,391	1,405,132	101,741
Corporate & Bank Excise			
Declarations	175,000	193,107	18,107
Miscellaneous	25,400	32,028	6,628
Gross	200,400	225,135	24,735
Refunds	14,200	36,662	22,462
Net	186,200	188,473	2,273
Sales Tax			
Gross	971,006	982,582	11,576
Refunds	22,448	38,439	15,991
Net	948,558	944,143	(4,415)
Motor Vehicle Excise	124,300	140,242	15,942
Other Revenues			
Inherit/Gift/Estate	11,767	14,506	2,739
Liquor/Wine/Beer	15,593	15,587	(6)
Cigarette & Tobacco	37,501	44,330	6,829
Deed & Mortgage	34,334	35,274	939
Insurance Gross Earnings	1,300	1,810	510
Lawful Gambling	17,040	17,240	200
Health Care Surcharge	39,162	38,416	(746)
Other Taxes	552	262	(290)
General Fund RTC Revenues	0	4,881	4,881
Income Tax Reciprocity	0	0	0
Investment Income	10,515	27,083	16,568
Other and Unallocated	17,200	29,467	12,267
Other Subtotal	184,964	228,855	43,891
Other Refunds	7,873	4,349	(3,523)
Other Net	177,091	224,506	47,414
TOTAL GROSS	2,806,770	3,003,929	197,158
TOTAL REFUNDS	67,230	101,433	34,203
TOTAL NET	2,739,541	2,902,496	162,955

FACTORS AFFECTING THE INDIVIDUAL INCOME TAX

(Dollars in Billions)

	Calendar Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Minnesota Non-Farm Tax Base						
November 1992 Control	81.250	85.198				
February 1993 Control	82.077	86.273				
November 1993 Control	82.471	86.332				
February 1994 Control	83.460	87.098				
November 1994 Control	84.722	88.266	91.982	96.902		
February 1995 Control	84.733	88.744	91.190	96.611		
November 1995 Control	85.120	90.170	94.160	97.766		
February 1996 Control	85.120	90.490	94.170	97.880		
November 1996 Control	84.720	90.720	95.750	100.57	105.170	109.96
Minnesota Wage and Salary Income						
November 1992 Control	59.830	62.466				
February 1993 Control	61.085	63.933				
November 1993 Control	61.203	63.959				
February 1994 Control	61.883	64.403				
November 1994 Control	62.562	65.234	68.004	71.395		
February 1995 Control	62.649	65.641	68.310	71.447		
November 1995 Control	62.844	66.389	69.518	72.278		
February 1996 Control	62.844	66.739	69.754	72.680		
November 1996 Control	62.737	67.004	71.244	74.966	78.407	82.127
Minnesota Property Income						
November 1992 Control	14.787	15.898				
February 1993 Control	14.776	15.937				
November 1993 Control	14.919	15.720				
February 1994 Control	15.027	15.958				
November 1994 Control	15.442	16.219	16.961	18.013		
February 1995 Control	15.400	16.315	16.985	17.933		
November 1995 Control	15.428	16.679	17.408	17.994		
February 1996 Control	15.428	16.653	17.077	17.604		
November 1996 Control	15.245	16.678	17.084	17.987	18.925	19.740
Minnesota Proprietors' Income						
November 1992 Control	6.633	6.834				
February 1993 Control	6.217	6.403				
November 1993 Control	6.348	6.653				
February 1994 Control	6.550	6.737				
November 1994 Control	6.718	6.813	7.016	7.494		
February 1995 Control	6.831	6.787	6.895	7.232		
November 1995 Control	6.845	7.103	7.238	7.490		
February 1996 Control	6.845	7.098	7.337	7.597		
November 1996 Control	6.741	7.071	7.422	7.617	7.834	8.099

FACTORS AFFECTING SALES, CORPORATE INCOME AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

	Fiscal Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>

SALES TAX

Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)

November 1992 Control	5.880	6.196				
February 1993 Control	5.984	6.252				
November 1993 Control	6.533	6.666				
February 1994 Control	6.672	6.934				
November 1994 Control	6.677	7.192	7.236	7.577		
February 1995 Control	6.675	7.273	7.308	7.558		
November 1995 Control	6.673	7.378	7.764	8.031		
February 1996 Control	6.673	7.378	7.729	8.151		
November 1996 Control*	6.587	7.286	7.759	8.197	8.601	8.948

Minnesota's Proxy Share of U.S. Capital Equipment Spending

November 1992 Control	8.079	8.753				
February 1993 Control	8.297	8.926				
November 1993 Control	8.678	9.322				
February 1994 Control	9.265	9.794				
November 1994 Control	6.754	7.450	7.665	7.702		
February 1995 Control	6.755	7.683	8.029	7.935		
November 1995 Control	6.744	7.866	8.613	8.763		
February 1996 Control	6.744	7.857	8.679	8.971		
November 1996 Control	6.403	7.301	8.069	8.757	9.316	9.900

Minnesota's Proxy Share of U.S. Construction Spending

November 1992 Control	8.841	8.969				
February 1993 Control	8.914	8.980				
November 1993 Control	9.412	9.809				
February 1994 Control	9.960	10.420				
November 1994 Control	4.680	4.770	4.813	4.973		
February 1995 Control	4.680	4.791	4.941	4.974		
November 1995 Control	4.511	4.641	4.830	5.024		
February 1996 Control	4.511	4.645	4.855	4.916		
November 1996 Control	4.525	4.759	4.966	5.105	5.243	5.356

* Reflects data revision.

FACTORS AFFECTING SALES, CORPORATE INCOME AND MOTOR VEHICLE EXCISE TAXES

(Dollars in Billions)

	Fiscal Year					
	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
SALES TAX (Cont.)						
Minnesota Non-Farm Personal Income						
November 1992 Control	95.003	100.074				
February 1993 Control	94.972	100.118				
November 1993 Control	96.090	100.800				
February 1994 Control	96.070	102.000				
November 1994 Control	97.810	102.120	106.48	111.74		
February 1995 Control	97.680	102.430	106.84	111.63		
November 1995 Control	97.640	104.500	108.91	113.59		
February 1996 Control	97.640	104.340	109.15	113.74		
November 1996 Control	97.140	104.120	110.87	115.94	121.93	127.60

MOTOR VEHICLE EXCISE TAX

Minnesota's Proxy Share of U.S. Consumption of Motor Vehicle and Parts Parts

November 1992 Control	4.494	4.713				
February 1993 Control	4.690	4.804				
November 1993 Control	4.944	5.356				
February 1994 Control	5.103	5.488				
November 1994 Control	4.929	5.320	5.322	5.491		
February 1995 Control	4.929	5.320	5.322	5.491		
November 1995 Control	4.948	5.264	5.479	5.560		
February 1996 Control	4.948	5.161	5.324	5.357		
November 1996 Control	4.948	5.149	5.310	5.381	5.582	5.806

CORPORATE INCOME TAX (Calendar Year)

U.S. Corporation Profits

November 1992 Control	445.2	445.2				
February 1993 Control	443.7	451.1				
November 1993 Control	448.0	469.6				
February 1994 Control	439.9	471.1				
November 1994 Control	428.5	476.3	465.3	491.6		
February 1995 Control	425.6	480.2	460.8	467.7		
November 1995 Control	425.6	475.9	477.4	476.7		
February 1996 Control	432.0	476.2	472.5	476.6		
November 1996 Control*	531.2	598.9	629.4	624.0	660.4	689.2

* Change in definition

F.Y. 1996-97 General Fund Budget
November, 1996 Forecast
(\$ in Thousands)

	Actual F.Y. 1996	11-96 Forecast F.Y. 1997	11-96 Forecast F.Y. 1996-97
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,020,499	1,343,277	1,020,499
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	4,135,332	4,376,600	8,511,932
Sales Tax	2,901,268	3,028,800	5,930,068
Corporate Income Tax	701,735	674,800	1,376,535
Motor Vehicle Excise	381,219	374,900	756,119
Other Non-Dedicated Revenue	867,950	887,009	1,754,959
Subtotal Net Non-Ded. Rev.	8,987,504	9,342,109	18,329,613
Dedicated Revenue	136,988	130,255	267,243
Transfers In	267,955	205,467	473,422
Prior Year Adjustments	8,521	20,450	28,971
Subtotal-Current Resources	9,400,968	9,698,281	19,099,249
Total Resources Available	10,421,467	11,041,558	20,119,748
Actual & Estimated Spending by Function:			
Education Aids	2,895,847	2,996,186	5,892,033
Property Tax Recognition	314,832	180,000	494,832
School Payment Change (90/10)	0	156,751	156,751
Post-Secondary Education	1,063,186	1,085,431	2,148,617
Property Tax Aids & Credits	1,212,587	1,199,274	2,411,861
Other Major Local Assistance	387,413	473,751	861,164
Health Care	1,383,280	1,593,014	2,976,294
Family Support	249,423	239,487	488,910
State Operated Institutions	397,610	428,913	826,523
Legisl., Judicial, Const. Officers	226,238	250,089	476,327
State Agencies' Ops. & Grants	659,377	763,039	1,422,416
Debt Service	197,589	241,345	438,934
Estimated Cancellations	0	(15,000)	(15,000)
Subtotal-Major Spending Categories	8,987,382	9,592,280	18,579,662
Dedicated Expenditures	90,808	130,255	221,063
Total Expenditures & Transfers	9,078,190	9,722,535	18,800,725*
Balance Before Reserves	1,343,277	1,319,023	1,319,023
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	220,000	261,000	261,000
School Aid Reserve	0	113,800	113,800
Appropriations Carried Forward	276,977	72,000	72,000
Budgetary Balance	496,300	522,223	522,223

* F.Y. 1997 includes a one-time increase in expenditures to fund a current law change to state fiscal year schedule of payments to school districts. Of the total \$156.7 million, \$149.9 million will be paid through Education Aids, and \$6.8

million through Property Tax Aids & Credits.

F.Y. 1996-97 Comparison
End-of-Session vs. November Forecast
(\$ in Thousands)

	4-96 Adopted F.Y. 1996-97	11-96 Forecast F.Y. 1996-97	Difference F.Y. 1996-97
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,020,499	1,020,499	0
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	8,084,450	8,511,932	427,482
Sales Tax	5,849,600	5,930,068	80,468
Corporate Income Tax	1,325,100	1,376,535	51,435
Motor Vehicle Excise	717,600	756,119	38,519
Other Non-Dedicated Revenue	1,683,134	1,754,959	71,825
Subtotal Net Non-Ded. Rev.	17,659,884	18,329,613	669,729
Dedicated Revenue	203,536	267,243	63,707
Transfers In	548,771	473,422	(75,349)
Prior Year Adjustments	40,900	28,971	(11,929)
Subtotal-Current Resources	18,453,091	19,099,249	646,158
Total Resources Available	19,473,590	20,119,748	646,158
Actual & Estimated Spending by Function:			
Education Aids	5,893,849	5,892,033	(1,816)
Property Tax Recognition	494,832	494,832	0
School Payment Change (90/10)	0	156,751	156,751
Post-Secondary Education	2,184,853	2,148,617	(36,236)
Property Tax Aids & Credits	2,404,982	2,411,861	6,879
Other Major Local Assistance	832,044	861,164	29,120
Health Care	3,154,196	2,976,294	(177,902)
Family Support	500,909	488,910	(11,999)
State Operated Institutions	843,917	826,523	(17,394)
Legisl., Judicial, Const. Officers	461,776	476,327	14,551
State Agencies' Ops. & Grants	1,453,820	1,422,416	(31,404)
Debt Service	446,894	438,934	(7,960)
Estimated Cancellations	(22,587)	(15,000)	7,587
Subtotal-Major Spending Categories	18,649,485	18,579,662	(69,823)
Dedicated Expenditures	203,080	221,063	17,983
Total Expenditures & Transfers	18,852,565	18,800,725*	(51,840)
Balance Before Reserves	621.025	1,319.023	697.998
Cash Flow Account	350,000	350,000	0
Budget Reserve	270,000	261,000	(9,000)
School Aid Reserve	0	113,800	113,800
Appropriations Carried Forward	0	72,000	72,000
Budgetary Balance	1,025	522,223	521,198

* F.Y. 1997 includes a one-time increase in expenditures to fund a current law change to state fiscal year schedule of

payments to school districts. Of the total \$156.7 million, \$149.9 million will be paid through Education Aids, and \$6.8 million through Property Tax Aids & Credits.

F.Y. 1998-99 General Fund Budget Forecast Annual Estimates (\$ in Thousands)

	11-96 Forecast F.Y. 1998	11-96 Forecast F.Y. 1999	11-96 Forecast F.Y. 1998-99
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,319,023	1,786,848	1,319,023
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	4,552,900	4,788,200	9,341,100
Sales Tax	3,171,900	3,329,200	6,501,100
Corporate Income Tax	676,800	708,100	1,384,900
Motor Vehicle Excise	371,300	384,900	756,200
Other Non-Dedicated Revenue	883,234	879,318	1,762,552
Subtotal Net Non-Ded. Rev.	9,656,134	10,089,718	19,745,852
Dedicated Revenue	120,255	120,255	240,510
Transfers In	219,529	237,951	457,480
Prior Year Adjustments	20,450	20,450	40,900
Subtotal-Current Resources	10,016,368	10,468,374	20,484,742
Total Resources Available	11,335,391	12,255,222	21,803,765
Actual & Estimated Spending by Function:			
Education Aids	2,944,775	2,994,345	5,939,120
Post-Secondary Education	1,064,590	1,105,670	2,170,260
Property Tax Aids & Credits	1,220,810	1,230,150	2,450,960
Other Major Local Assistance	496,315	520,296	1,016,611
Health Care	1,805,445	2,050,650	3,856,095
Family Support	269,636	289,837	559,473
State Operated Institutions	439,696	460,681	900,377
Legisl., Judicial, Const. Officers	236,404	243,800	480,205
State Agencies' Ops. & Grants	706,402	722,420	1,428,822
Debt Service	249,213	296,683	545,896
Estimated Cancellations	(5,000)	(15,000)	(20,000)
Subtotal-Major Spending Categories	9,428,287	9,899,533	19,327,821
Dedicated Expenditures	120,255	120,255	240,510
Total Expenditures & Transfers	9,548,542	10,019,788	19,568,331
Balance Before Reserves	1,786,848	2,235,434	2,235,434
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	261,000	261,000	261,000
School Aid Reserve	113,800	113,800	113,800
Appropriations Carried Forward	72,000	72,000	72,000

Budgetary Balance

990,048

1,438,634

1,438,634

Biennial Comparison
F.Y. 1996-97 to F.Y. 1998-99
 November General Fund Forecast
 (\$ in Thousands)

	11-96 Forecast F.Y. 1996-97	11-96 Forecast F.Y. 1998-99	\$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,020,499	1,319,023	298,524	29.3%
Current Resources:				
Net Non-Dedicated Revenue				
Individual Income Tax	8,511,932	9,341,100	829,168	9.7%
Sales Tax	5,930,068	6,501,100	571,032	9.6%
Corporate Income Tax	1,376,535	1,384,900	8,365	0.6%
Motor Vehicle Excise	756,119	756,200	81	0.0%
Other Non-Dedicated Revenue	1,754,959	1,762,552	7,593	0.4%
Subtotal Net Non-Dedic Revenue	18,329,613	19,745,852	1,416,239	7.7%
Dedicated Revenue	267,243	240,510	(26,733)	-10.0%
Transfers In	473,422	457,480	(15,942)	-3.4%
Prior Year Adjustments	28,971	40,900	11,929	41.2%
Subtotal-Current Resources	19,099,249	20,484,742	1,385,493	7.3%
Total Resources Available	20,119,748	21,803,765	1,684,017	8.4%
Actual & Estimated Spending by Function				
Education Aids	5,892,033	5,939,120	47,087	0.8%
Property Tax Recognition	494,832	0	(494,832)	nm
School Payment Change	156,751	0	(156,751)	nm
Post-Secondary Education	2,148,617	2,170,260	21,643	1.0%
Property Tax Aids & Credits	2,411,861	2,450,960	39,099	1.6%
Other Major Local Assistance	861,164	1,016,611	155,447	18.1%
Health Care	2,976,294	3,856,095	879,801	29.6%
Family Support	488,910	559,473	70,563	14.4%
State Operated Institutions	826,523	900,377	73,854	8.9%
Legisl., Judicial, Const. Officers	476,327	480,205	3,878	0.8%
State Agencies' Operations & Grants	1,422,416	1,428,822	6,406	0.5%
Debt Service	438,934	545,896	106,962	24.4%
Estimated Cancellations	(15,000)	(20,000)	(5,000)	33.3%
Subtotal-Major Spending Categories	18,579,662	19,327,821	748,158	4.0%
Dedicated Expenditures	221,063	240,510	19,447	8.8%
Total Expenditures & Transfers	18,800,725*	19,568,331	767,605	4.1%
Balance Before Reserves	1,319,023	2,235,434	916,411	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	261,000	261,000	0	
School Aid Reserve	113,800	113,800	0	
Appropriations Carried Forward	72,000	72,000	0	
Budgetary Balance	522,223	1,438,634	916,411	

* F.Y. 1997 includes a one-time increase in expenditures to fund a current law change to state fiscal year schedule of

payments to school districts. Of the total \$156.7 million, \$149.9 million is will be paid through Education Aids, and \$6.8 million through Property Tax Aids & Credits.

1998-99 General Fund Budget Forecast Comparison: End-of-Session vs. November, 1996 Forecast (\$ in Thousands)

	4-96 Plnd Est F.Y. 1998-99	11-96 Forecast F.Y. 1998-99	\$ Difference
Actual & Estimated Resources:			
Balance Forward From Prior Year	621,025	1,319,023	697,998
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	8,685,500	9,341,100	655,600
Sales Tax	6,187,670	6,501,100	313,430
Corporate Income Tax	1,329,500	1,384,900	55,400
Motor Vehicle Excise	760,000	756,200	(3,800)
Other Non-Dedicated Revenue	1,620,103	1,762,552	142,449
Subtotal Net Non-Ded. Rev.	18,582,773	19,745,852	1,163,079
Dedicated Revenue	162,000	240,510	78,510
Transfers In	475,628	457,480	(18,148)
Prior Year Adjustments	40,900	40,900	0
Subtotal-Current Resources	19,261,301	20,484,742	1,223,441
Total Resources Available	19,882,326	21,803,765	1,921,439
Actual & Estimated Spending by Function:			
Education Aids	5,940,140	5,939,120	(1,020)
Post-Secondary Education	2,163,623	2,170,260	6,638
Property Tax Aids & Credits	2,409,665	2,450,960	41,295
Other Major Local Assistance	970,719	1,016,611	45,892
Health Care	3,792,512	3,856,095	63,584
Family Support	539,903	559,473	19,571
State Operated Institutions	937,909	900,377	(37,532)
Legisl., Judicial, Const. Officers	479,881	480,205	323
State Agencies' Ops. & Grants	1,408,870	1,428,822	19,952
Debt Service	548,343	545,896	(2,447)
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal-Major Spending Categories	19,171,564	19,327,821	156,256
Dedicated Expenditures	162,000	240,510	78,510
Total Expenditures & Transfers	19,333,564	19,568,331	234,766
Balance Before Reserves	548,761	2,235,434	1,686,673
Cash Flow Account	350,000	350,000	0
Budget Reserve	270,000	261,000	(9,000)
School Aid Reserve	0	113,800	113,800
Appropriations Carried Forward	0	72,000	72,000
Budgetary Balance	(71,239)	1,438,634	1,509,873

* F.Y. 1997 includes a one-time increase in expenditures to fund a current law change to state fiscal year schedule of payments to school districts. Of the total \$156.7 million, \$149.9 million will be paid through Education Aids, and \$6.8 million through Property Tax Aids & Credits.

F.Y. 1996-2001 Planning Horizon
November, 1996 General Fund Forecast
(\$ in Thousands)

	11-96 Forecast F.Y. 1996-97	11-96 Forecast F.Y. 1998-99	11-96 Plng Est F.Y. 2000-01
Actual & Estimated Resources:			
Balance Forward From Prior Year	1,020,499	1,319,023	2,235,434
Current Resources:			
Net Non-Dedicated Revenue			
Individual Income Tax	8,511,932	9,341,100	10,194,800
Sales Tax	5,930,068	6,501,100	7,077,300
Corporate Income Tax	1,376,535	1,384,900	1,516,500
Motor Vehicle Excise	756,119	756,200	819,800
Other Non-Dedicated Revenue	1,754,959	1,762,552	1,789,210
Subtotal Net Non-Ded. Rev.	18,329,613	19,745,852	21,397,610
Dedicated Revenue	267,243	240,510	240,510
Transfers In	473,422	457,480	471,262
Prior Year Adjustments	28,971	40,900	40,900
Subtotal-Current Resources	19,099,249	20,484,742	22,150,282
Total Resources Available	20,119,748	21,803,765	24,385,716
Actual & Estimated Spending by Function:			
Education Aids	5,892,033	5,939,120	6,323,788
Property Tax Recognition	494,832	0	0
School Payment Change (90/10)	156,751	0	0
Post-Secondary Education	2,148,617	2,170,260	2,311,684
Property Tax Aids & Credits	2,411,861	2,450,960	2,466,925
Other Major Local Assistance	861,164	1,016,611	1,106,933
Health Care	2,976,294	3,856,095	4,794,967
Family Support	488,910	559,473	620,777
State Operated Institutions	826,523	900,377	991,572
Legisl., Judicial, Const. Officers	476,327	480,205	509,225
State Agencies' Ops. & Grants	1,422,416	1,428,822	1,516,606
Debt Service	438,934	545,896	582,386
Estimated Cancellations	(15,000)	(20,000)	(20,000)
Subtotal-Major Spending Categories	18,579,662	19,327,821	21,204,863
Dedicated Expenditures	221,063	240,510	240,510
Total Expenditures & Transfers	18,800,725*	19,568,331	21,455,373
Balance Before Reserves	1,319,023	2,235,434	2,940,343
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	261,000	261,000	261,000
School Aid Reserve	113,800	113,800	113,800
Appropriations Carried Forward	72,000	72,000	72,000
Budgetary Balance	522,223	1,438,634	2,143,543

* F.Y. 1997 includes a one-time increase in expenditures to fund a current law change to state fiscal year schedule of payments to school districts. Of the total \$156.7 million, \$149.9 million will be paid through Education Aids, and \$6.8 million through Property Tax Aids & Credits.